

**NON-AUDIT SERVICES, AUDIT QUALITY, AND FRAUDULENT FINANCIAL  
REPORTING AMONG LISTED FIRMS IN NSE, NAIROBI, KENYA**

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Requirements for the Master Degree in Business Administration (Accounting Option) of  
Egerton University**

**EGERTON UNIVERSITY**

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## DECLARATION AND RECOMMENDATION

### Declaration

This project is my original work and has not been presented for award of any academic examination in any other university or for any other award.

Signature 

Date...25<sup>th</sup> June 2024

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### Recommendation

I confirm that the work reported in this research project was carried out by the candidate under my supervision and has been submitted with my approval as university supervisor.

Signature 

Date...25<sup>th</sup> June 2024

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## **DEDICATION**

I would like to dedicate this thesis to my family and friends. A special thank you to my loving parents, Moses and Celline Mwashu who kept on encouraging me to push harder during the learning period. My siblings Millicent, Victor and Hillary who never gave up on me. I would like to appreciate my spouse Haron and offspring Lianie and Emin who were by my side during this period. You have all been my cheer leaders.

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## **ABSTRACT**

The NSE firms contribute highly to national economic growth thus if fraudulent reporting is left without being detected, it will highly affect the public just like the Anglo leasing effects that are still being experienced in Kenya. This research sought to examine the relationship between Non-audit service, audit quality and fraudulent financial reporting among listed firms in NSE. The specific objective was to establish the effect of Non-audit service on fraudulent financial reporting, the effect of Audit quality on Fraudulent Financial reporting and lastly to establish the joint effect of Non Audit service, Audit Quality and Fraudulent Financial reporting among firms listed in NSE. The study used a descriptive research design with a study population of 63 as listed by NSE 2023 and a Census survey was adopted. The researcher targeted the appointed internal auditors from each firm as the respondents. The data was of primary nature where 57 closed ended questionnaires were dropped and picked for analysis while the 6 questionnaires were used in pilot study. The data collected was run via SPSS software. Quantitative method of analyzing data that is descriptive statistical method where the statistical tools such as mean, mode and standard deviation was adopted. Inferential statistic such as simple and multiple regression models was used to predict the relationships among the variables. Findings on the first objective showed that non audit service has positive and insignificant effect on fraudulent financial reporting. On the second objective, findings showed that audit quality positively but significantly affect the fraudulent financial reporting among firms listed in NSE. Finally, the joint effect Non-Audit service and Audit quality have positive and statistically significant effect on fraudulent financial reporting among firms listed in at a minimum of 95% confidence level. The study recommends that further research be conducted on other factors not covered under this study; that contribute to fraudulent financial reporting to assist in uncovering fraudulent financial reporting. The study is significant to investors, portfolio managers and other market players to make the best decisions in regard to the investments. The study is also significant to those charged with governance to ensure there is production of quality financial statements.

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## **LIST OF ABBREVIATIONS AND ACRONYMS**

<b>NAS:</b>	Non-Audit Services
<b>SPSS:</b>	Statistical Package for Social Sciences
<b>NACOSTI:</b>	National Commission for Science, Technology and Innovation
<b>KPMG:</b>	Klynveld Peat Marwick Goerdeler
<b>ISA:</b>	International Standards of Auditing
<b>EACC:</b>	Ethics and Anti-Corruption Commission
<b>GDP:</b>	Gross Domestic Product
<b>CBK:</b>	Central Bank of Kenya
<b>PWC:</b>	Price water Coopers
<b>NSE:</b>	Nairobi Securities Exchange

# **CHAPTER ONE**

## **INTRODUCTION**

### **1.1 Background of the Study**

The efficiency of internal audit helps develop the work of the company because the financial reports reflect the internal audit department's quality (Al-Matari et al., 2014). The value or rather quality of an audit lies on the perception of users of audited financial statements judging on the auditor's ability to detect errors or fraud in the accounting system and to resist client pressures to disclose such discoveries (DeAngelo, 1981). Auditing only adds meaning to the users when they have confidence in the auditor that he is able to uphold independence and report the findings correctly. The key role of auditors in the society is to contribute towards financial performance in ways such as reducing risk of significant misstatements and financial statements adhering to present rules and regulations (Hay et al., 2014). There has been numerous reports on audit failure that led to worldwide criticism of auditing as a profession that led to lack of trust by shareholders in terms of guarding their interest (Krishnan, 2005).

Audit fee determination has also been an issue of concern as to what determines the level of audit fees (remuneration payable) due to the huge elephant that exists where audit firms tend to charge huge fees, yet the reports given are totally opposite from the reality. The responsibility of detection and prevention of frauds and errors rests with the Management (Matoke & Omwenga, 2016). Non-Audit Services and the Timeliness and Reliability of Earnings Announcements, both audit and non-audit services need a number of factors such as the operating environment, client's organizational structure knowledge, business processes together with industry (Hogan et al., 2018). Audit knowledge can lead to a reduction in audit start-up time as well as the transaction costs (Knechel et al., 2012). Non audit services also provide the audit firm with further access and knowledge on the client's systems, business risks, and material transactions made during the year that helps identify the audit risks earlier and solving accounting issues in a timely manner (De Simone et al., 2015).

Auditing recorded a history in the US during the fall of Arthur Andersen. The going concern opinions to the former and recent clients was examined and the result was a modified audit opinion. There was reduced conservatism by the new auditor compared to Andersen's opinion (Krishnan et al., 2007). Later in October 2001, Enron faced accounting discrepancies reported as authentic by Arthur Andersen and ran into bankruptcy in December 2002 where Arthur Andersen

was found guilty and faced criminal charges. The provision of NAS deters independence of auditors due to the economic bond that forms during interaction with the client making the exert pressure to the auditor to manipulate the financial statement. This leads to the widespread debate on the suggestion that auditors should not be allowed to provide non-audit services (Hodge & Murray, 2012).

In the recent past, the world has experienced a rise in corporate failures, financial scandals and audit failure. This has stimulated firm debate among the accounting profession's regulators and the public about the audit expectations gap. This is because the accounting information users often ask where the auditor was when the scandals were taking place. Some accounting information users therefore seem to partly blame the auditors for corporate failures (Kalui & Mbakaya, 2014). With the collapse of Enron involving the misconduct of one of the Big 4, Arthur Andersen & Co., the argument for audits for big audit firms as synonymous with quality audit has become questionable. These corporate scandals confirmed a requirement for high quality audit and considerable attention to different factors that may have an effect on audit quality. High quality audit refers to the production of financial information without misstatements, omissions or biases. From an agency theory perspective, audited financial statements are a monitoring mechanism to provide assurance for users of financial information (Dang, 2004).

In South Africa, a fraud survey was conducted by a survey leader on global economic crime and fraud. The findings showed that South African Organizations that were experiencing economic crime was at 77%. The report declared that the companies faced fraud risk from internal, external and regulatory as senior management were the major fraudsters within organizations. In the same report, it was reported that ,top ten countries that was facing most economic fraud entailed; South Africa at 77%, Kenya at 75%, France at 71%, Russian Federation at 66%, Uganda at 66%, Zambia at 65%, Belgium at 65%, China at 63%, Mexico at 58% and Tanzania at 57%, (PwC, 2024).

In East Africa: Kenya, Uganda, Burundi, and Tanzania made up 74% of all the financial fraud cases in the Eastern region of Africa with Kenya standing at 23% of the total cases, Burundi at 21%, Uganda at 18% and Tanzania at 12 %. It added that majority of fraud cases in East Africa that entailed misappropriation of funds, bribery and corruption mostly targeted governments and financial sectors and were extremely high in organizations found in Kenya. The Non-audit services became of essence in accountancy firms where KPMG advisory services constituted a revenue of

37.2% of total revenue in the year, while PwC reported a revenue of 31.8% of the total revenue (Yu, 2017).

Kenya being the scope of the study, contributes to this study due to the recent graft cases. In 2017, it was reported that, a lot of corruption and bribery had occurred in Kenyan public procurement while awarding the public contracts. Kenya has also witnessed fraud occurrence in companies such as the National Youth Service that lost about 791 Million, the loss at Kenya Pipeline, Mumias Sugar Company, Sony sugar, Barclays bank and NCPB Maize depot scandal among others (Mutangili, 2019). High level of corruption took place in the sector of energy, construction of airport and infrastructure during procurement processes, (PwC, 2016). There was also a frequent diversion of public funds by public officials (GCR, 2017). In Kenya, Deloitte after assessing CMC motors financial reports fails to recognize losses from CMC assets that were damaged, failing to disclose the auto firm's subsidiary. In South Sudan in the annual reports, abetting the booking of undelivered vehicle sales as revenues and not capturing interest payments for cars sold on credit (Guandaru & Nduati, 2012).

Based on the private sector, a clique of top managers of Imperial Bank were in court summoned for allegedly parting with more than 34 billion from the bank deposits. On the Business daily Africa on the Big four audit firms winning big banks in audit jobs contributes to this study. It was denoted that, 'two of the big four audit firms trounce rivals, bagging 10 out of 11 NSE-listed lenders.'. He reported that KPMG and Price water house Coopers emerged the biggest winners in the reshuffle of bank auditors in compliance with CBK directive. In the report, Ernst and Young managed to pick Coop bank for audit while PWC missed the trade. He reported that the fees paid to the Big four were ranked in a total of sh. 241.84 million of professional fees from the listed banks that showed an increase of 6.1% from the previous year. Co-op bank was interviewed about the issue of audit fees growth and they claimed that the fee rose due to inflation (David, 2017). Contrary to this, the Institute of Certified Public Accountants of Kenya (ICPAK) ruled to cap the fees an audit firm can derive from a potential client as 10% of its total annual revenue. Accountants have to take caution when negotiating for professional work to avoid impairment of their independence, thus audit engagement letter must provide a basis for charging fees (Avram & Togoe, 2012; West, 2017). Bribery, tax evasion, financial statement fraud, misappropriation of funds and forgery are still dominant in state corporations (EACC, 2017).

Internal auditors are key in the effectiveness of internal control in an organization. Their approach to auditing has become more proactive and external auditors often rely on their work papers relating to internal control (Chang et al., 2019). Auditing being both internal and external, is listed as a corporate governance component that influences financial performance as it promotes financial accountability and minimizes the fraud occurrence (Tumwebaze et al., 2018). When focusing on external audit, the audit quality is determined by factors relating to the audit team, the audit plan, the audit company and the audit fees. Specifically, auditor size, audit fees, auditors' expertise, and auditor's independence have a significant impact on financial outcomes of a firm, and since companies select their external auditors (Ado et al., 2020; Tumwebaze et al., 2018). Since companies select their external auditors, they have the ability to influence financial performance.

External auditors' attributes influence financial performance through their impact on the audit quality as the Audit quality is the extent that an independent audit identifies and discloses errors or frauds, detects suspicious accounting practices, and assures that there are no material errors in the financial statements. It is dependent on the auditor's compliance of with existing standards and legal guidelines related to external audit practices (Dalgic & Caliyurt, 2019). Auditor attributes influence the auditor's ability to ensure a high-quality audit. Auditors should ensure that the financial report does not contain any material misstatements, and any deficiencies identified are addressed and reported. Audit quality is important in generating confidence in the accuracy of financial reporting and quality audit is associated with increased investor confidence (Cameran et al., 2017).

The emergence of professional service firms in recent years has resulted from a growing demand from businesses for specialist advice to help them achieve business advantage in an increasingly competitive marketplace. The Non-Audit Services provided by auditors to their audit clients such as management advisory services, tax services, accounting services, corporate finance services and assurance services have been regarded by regulatory authorities (Okah, 2013). In a much the professional auditors provide the non-audit services it is envisioned that the services provided do not interfere with the audit of quality of the firms. Audit quality refers to matters that contribute to the likelihood that the auditor will achieve the fundamental objective of obtaining reasonable assurance that the financial report as a whole is free from material misstatement (Price, 2014). The factors taken into consideration regarding audit quality include audit independence, auditors' tenure and auditors' opinion (Tepalagul & Lin, 2015).

### **1.1.1 Non-audit Services**

Non-audit services as defined by the Big 4's are consulting and advisory services, human capital services, taxation, any assistance provided under conditions regulated, technological access and provision of strategic solutions (Deloitte, 2019). Non-audit services found popularity globally in countries such as Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, and Sweden. This occurred after these countries faced increased audit independence impairment and conflict of interest when NAS was performed by auditors. As a result, tight rules and regulations were kept in place by Serbian-Oxley act (SOX), European commission in order to regulate and curb the issues (Yu, 2017). In the US, the use of advisory services has been embraced especially in the banking sector. Most financial firms allocate huge funds to consultancy and advisory services.

The trend is also evident in the UK where most firms have adopted advisory services as a key determinant of the success of corporations. The study also cited the adoption of the services by Asian countries such as India where they disclosed that management advisory services are crucial in proper running of corporations in the world (Frenkel & Shenhav, 2012). In Canada, Assurance can only be attained if the audit guidelines and standards are met. Internal auditors working on assurance should have quality audit work for them to assess assurance matters. Leaders should come up with strategies that encourage auditors to comply with assurance standards. All the firms have the duty to ensure the audit department comply with the assurance standards (Boiral & Gendron, 2011). A study conducted in Korea stipulated that non-audit services affect audit service quality before controlling endogeneity. Contrary to that, the provision of non-audit services by the same independent auditor did not affect the audit service quality.

In Nigeria, a study was carried out on the effect of audit firm size, Non-audit services and audit quality. The study concluded that, Non-audit services is key as it gives wide knowledge to the auditor regarding the organization (Ubaka, 2017). This knowledge eventually helps the auditor learn more about the organization under audit thus increased audit quality (Comprix & Huang, 2015). The result concurs with Chukwunedu and Okafor (2014) who conducted a study in Nigeria. They stipulated that, some Non-audit services should be selected and some prohibited as the provision of NAS impairs audit independence. In line with that, the central bank of Nigeria bars the provision of some NAS services to its clients. In addition, the Nigerian security and Exchange commission was being kept in place to legislate on the provision of both audit and NAS service to

listed companies in Nigeria. In Ghana, a study reveals that, the Big 4 audit firms compared to the non-big 4 charge clients high non audit fees when providing non audit services. This was as a result of adopting IFRS leading to weak financial regulatory regime that needs to be looked into (Musah et al., 2018).

In Kenya, Assurance services are crucial in checking the quality of the services offered by a company. Most firms do not follow the set standards and guidelines. Failure to compliance is linked to lack of knowledge of the assurance standards and age and experience of most audit Companies. Some companies do not understand the assurance standards. The authors used correlation analysis where they found a positive relationship between compliance quality level and the experience of the audit firm (Okibo & Kamau, 2012). Tax Audit Services refers to the provision of knowledge and training on tax laws and tax accounting services (Kamuruchi, 2016). Taxation involves, amongst others, assisting clients to prepare the tax returns and in planning their tax. Tax audit services are performed to ensure an individual or organization complies with the state tax laws and regulations. Tax audit services enable the internal revenue support system to cross-check the number of times the organization and individual has filed their tax return. A tax audit is of essence as it assists the government to collect appropriate tax revenue which is necessary for financial and economic stability.

In Kenya, advisory services are regarded as source of highly competitive edge by the companies due to available expertise, knowledge, methodologies, and best practices. Most advisory services in Kenyan case are provided by KPMG, PWC, Delloite, EY, PKF, AON, Parker Randall, and Grant Thornton. Most businesses in Kenya go for advisory services with the aim of gaining competitive edge and to increase returns on shareholders. Most consultancy services are seen as change agents in terms of increasing profit and productivity (van Nistelrooij & Sminia, 2010). Tax audit services determine if an individual will comply with tax laws and regulations. Fines and penalties do not always have a positive impact on tax compliance. In addition, early tax audit services have more impacts on compliance rates and long-term compliance with tax audit services reduces when one is not audited for an extended duration (Kastlunger et al., 2009). A study on the role of management advisory services in Kenya found out that clients base advisory services based on three things i.e. business perspective, financial management and gaining of new knowledge. There is a positive impact on the financial performance standpoint through involvement of management consultancy. In their study, it was found out that 58% of the clients

get satisfied with the results they obtain from advisory services while 41% were uncertain (Sturdy et al., 2009).

In USA, research was conducted and 87% of the companies with Big Eight incumbent auditors purchased non audit services, 10% bought them exclusively from the incumbent while the remaining purchased from both the incumbent auditor and non-incumbents. The author also noted that large clients purchased non-audit services more frequently compared to the smaller (Palmrose, 1986).

### **1.1.2 Audit Quality**

In Asia, a study was carried out on the relationship between Economic Importance of clients and Auditor Independence in Asian Countries. They stipulated that, applying strict regulations after the financial crisis that had occurred in Asia reduced the chances of auditors compromising with their independence. This meant that auditors would stick to and comply with the audit standards thus reducing any chances of compromise. Findings showed that, the same scenario happens in countries such as Hong Kong, Indonesia, Malaysia, Singapore, Taiwan and Thailand among other (Zhou & Zhu, 2012).

In London and New York, ambiguity was faced by researchers and academicians on conceptualizing the idea behind the component of audit independence as it gives room for manipulation leading to more ambiguities. The study showed that, Audit independence is a function of existence of the dispute among auditors and clients in reference to the audit reporting issues such as fraud and financial misstatement (Adelopo, 2016). In United States, a study showed that the strength of the economic bond between the auditor and client reduces independence. Although some suggest that audit fees affect auditor independence, other researchers found out that, higher fees is not in most cases associated with reduced auditor independence but rather higher audit quality is related to availability or interaction with more important clients as measured by fees (Gaver & Paterson, 2014).

In Nigeria, a study was conducted on the determinants of Audit Independence. The study denoted that, Audit independence is the ability of the external auditors to do their duties with integrity more so based on perception rather than actual independence (Akpom & Dimkpah, 2013). In Ghana, a study was conducted on effective audit committee, audit quality and earnings management. Findings showed a negative relationship between the variables. The researcher mentioned that, African countries Ghana being one of them have weak legal and judicial systems

together with limited human skills that deals with corruption prevention. In regard to that, auditors have no better skills in detecting and preventing earnings management negative practices (Agyei-Mensah & Yeboah, 2019). According to past research, it was found out that the larger the size of audit fees, the higher the risk of losing the independence of the auditors that eventually affects the quality of the audit. Audits that regard initial costs as significant makes the existing auditor enjoy a competitive advantage in further audits. In 2002, Arthur Andersen, a public accounting firm experienced failure that led to inspection of public auditors practices (Eisenberg & Macey, 2004). Failure of Arthur Andersen and other accounting industry raised concern over the ethics of professional accountants which led to questioning of the overall audit quality on audit profession (Gendron & Spira, 2008).

In Kenya, audit firms have grown and increased rapidly in number though the BIG 4 still dominates. Auditing as a service has faced critic and immense pressure. This is due to the high expectations borne by the clients for them to produce high quality work as a result of past situations where auditors failed to detect fraud and error leading to the collapse of the companies. Audit firms are said to have lacked technical capacity and they have been under capitalized. They have shifted to building profitable operations in and drifted from their core aim as auditors. The Big 4 especially have dominated the Kenyan market by representing and branding themselves heavily taking advantage of the available loopholes to enrich themselves. ICPAK was kept in place to legislate and regulate auditing as a profession where disciplinary actions are undertaken when auditors break the code of conduct. In addition, computerized auditing where audit software's are used has been embraced by audit firms so as to safeguard the information to produce quality work (Oginga, 2013).

### **1.1.3 Fraudulent Financial Reporting**

Fraudulent Financial Reporting is the acquisition of finances or economic advantage by means of deception, through either a misrepresentation or concealment. It's also a deliberate misinterpretation in financial position accomplishment through intentional omission or misstatement of the financial system to deceive the users. Fraudulent Financial Reporting can be measured using various indicators such as Asset Misappropriation, Financial statement Fraud, Improper Expense recognition, Overstating Assets, Revenues and Understating liabilities and expenses.

Asset misappropriation is a state where the assets that's have been entrusted in the hands of directors, employees or trustees are stolen thus it's the theft or misuse of funds placed in one's trust or belonging to an employer. In Malaysia, the assets that were mostly misused by local Authorities where vehicles and internet connections due to lack of internal control, lack of employee's fraud education, lack of independent cheques, override of existing controls, and lack of management reviews, attitude, and lack of awareness of the dishonest acts (Ab Majid et al., 2014). Still in the same country, a researcher found out that there are four conditions that give a loop for misappropriation at a place of work; lack of or poor internal controls, lack of employee screening, absence of management supervision, over control by a specific group of employees only (Mohamed et al., 2021). In Asia theft and misappropriation of cash and cheques is also classified as another form of fraud (Akinyomi, 2012). In Europe, study found out that, employees can misappropriate assets by taking advantage of organizations credit cards and spending it to buy personal items leading to great losses that eventually lead to poor organizational performance (Kerber et al., 2015).

In Nigeria a study on Frauds in Nigerian banks was conducted. They found out that, specific institutional factors may lead to financial risk fraud. Among the identified factors include poor accounting control systems, poor communication and technology and inadequate supervision in the place of work. Other factors include social factors such as the desire to get rich while young, financial burden, societal expectations, and job insecurity. The study concluded that to lower fraud cases requires companies to have an internal control system in line with the operational framework. They recommended that, there is need to respect and trust internal control systems in all organizations whether private or parastatals. Businesses should develop clear and precise responses towards financial fraud detection. Also, creating comfortable working conditions helps to reduce the occurrence of financial fraud in an organization. The study therefore argues that financial fraud is not only affected by the audit quality but by the insider employees who have access to cash and the security measures (Adeyemo, 2012).

In Kenya, May 2016, the government aired several state corporations that had misappropriated funds and they were: sugar companies in western Kenya, Kenya Ports Authority (KPA), Kenya Revenue Authority (KPA), Kenya Revenue Authority (KRA) and Kenya Maritimes Authority (KMA). A study on Effect of Financial Misstatement and Corruption on Fraud Risk among State Corporations in Mombasa County in Kenya adds to this study. There was a positive

relationship among the variables recommendation for the adoption of policies to handle financial statements like forensic accounting and auditing (Gilbert et al., 2019). Financial statement fraud and asset misappropriation is a common types of fraud committed (ISA240). The Uchumi supermarket that nearly collapse in 2006 also raised eyebrows on the authenticity of misstatement detection by the Deloitte audit firm after the company was investigated later by PWC.

A study was carried out on financial fraud risk assessment on Barclays bank in Kenya. A single institution was selected in all population size on banks in Kenya for in depth analysis of data. The study analyzed methods in which fraud is committed by external and internal fraudsters. Control measures put into place and how resilient the bank was also analyzed. Bank fraud specialists were interviewed to determine how financial fraud in banks is performed. It was concluded that the bank's financial fraud in financial statements is facilitated by the employees together with the third parties (Kimani, 2011). Another study that concurred with this determined equity bank response to financial risk fraud. It was established that the worst financial statement fraud is identity risk where fraudsters make use of parallel passports. Cheques fraud was also found to be common among private institutions. Another conclusion drawn was that there exist whistle blowing facilities in Kenyan banks (Wanjiku, 2011).

#### **1.1.4 Nairobi Securities Exchange**

Under the Societies Act, Nairobi Securities Exchange was established and registered in 1954 as a voluntary association of stockbrokers (Ngugi & Njiru, 2005). In 1988, there was a successful sale of a 20% government stake where the Government of Kenya and its affiliate institutions retained about 80% of ownership during the privatization. NSE shifted its location to Nation Centre in and set up a computerized delivery and settlement system in July 1994. It later upgraded its website in February 2007 in order to enhance easy and faster access of accurate, factual and timely trading information. In July 2007, NSE reviewed the Index and announced the companies that would constitute the NSE Share Index so as to ensure a true barometer of the market (NSE, 2011).

A Wide Area Network platform was implemented in 2007 which eradicated the need for brokers to send their dealers to the trading floor to conduct business. The majority of trading was conducted from the brokers' offices through the Wide Area Network. In 2008, the NSE All Share Index (NASI) was introduced as an alternative index. In July 2011, the Nairobi Stock Exchange Limited changed its name to the Nairobi Securities Exchange Limited where the change reflected

the strategic plan of the Nairobi Securities Exchange of evolving into a full service securities exchange which supports trading, clearing and settlement of equities, debt, derivatives and other associated instruments (NSE, 2014).

## **1.2 Statement of the Problem**

Currently, fraud termed as corruption in the top companies, has become a major area of concern investigated even by the top officials, such as the DCI'S office. Following the report released in Nairobi by the audit firm, most of economic crimes continue to be committed by internal fraudsters who were responsible for 70% of the cases reported by the Kenyan organizations (Muniu, 2018). Beekes and Brown (2006), in their study noted the idea of increased concern over corporate accountability in the developed countries that was because of the need for appropriate audit.

This has been witnessed by fraudulent reporting in companies such as the NYS of 791 Million, Kenya Pipeline, Mumias Sugar Company, NCPB Maize, Imperial Bank of 34 Billion from bank deposits among others (Mutangili, 2019). It denoted that; majority of these sectors that experienced graft cases were often audited by the Big four Audit firms. This raises questions about the integrity of auditors in the Big four: KPMG, Ernst & Young, Deloitte Touché and PWC and other audit firms as to whether the work they do is worth the large audit fees they collect yet the sector remains a major graft war zone in Kenya. KPMG pocketed 90.2 million audit fees in 2018, PWC earned 79.3 Million, and EY earned 60.1Million in 2016 while Deloitte made 12.06 Million in 2018. The order required banks to hire auditors on a rotating basis following the collapse of three banks that are Dubai bank, Imperial bank and Chase bank (Warui, 2014).

In the research conducted by David (2017), the study advocated that the Big four have locked out middle-tier consultancy firms from auditing lucrative listed Banks considering that auditing them is associated with huge fees. The NSE firms contribute highly to national economic growth thus if fraudulent reporting is left without being detected, it will highly affect the public just like the Anglo leasing effects that are still being experienced in Kenya (Bachelard, 2010). From the literature reviewed on audit quality and non-financial services many scholars have indicated that audit quality and non-audit services are of benefit to various institutions. However, these studies have been conducted outside Kenya. In the local context Kwabena (2017) carried out the study on audit quality in other sectors other than listed firms on the NSE. These studies revealed varying results. Based on this reviewed literature, the study has identified that few studies

have been found to focus on audit quality, non-financial services and fraudulent financial reporting on listed firm on the NSE, this is the gap this study is leveraged on. The study sought to answer the research question; what is the relationship between non-audit services, audit quality and fraudulent financial reporting among the firms listed in NSE?

### **1.3 Objectives of the Study**

#### **1.3.1 General Objective**

The general objective of the study was to determine the relationship between Non-Audit Services, Audit Quality and Fraudulent Financial Reporting among firms listed in NSE.

#### **1.3.2 Specific Objectives**

- i) To determine the effect of Non-audit Service on fraudulent financial reporting among firms listed in NSE.
- ii) To determine the effect Audit quality on fraudulent financial reporting among firms listed in NSE.
- iii) To determine the joint effect of Non audit service and audit quality on fraudulent financial reporting among firms listed in NSE.

### **1.4 Research Questions**

The following hypothesis was tested in order to achieve the objectives:

**Ho1:** There is no significant relationship between Non-audit and fraudulent financial reporting among firms listed in NSE.

**Ho2:** There is no significant relationship between Audit Quality and fraudulent financial reporting among firms listed in NSE.

**Ho3:** There is no significant relationship between Non-Audit service, Audit quality and fraudulent financial reporting among firms listed in NSE.

### **1.5 Significance of the Study**

This study is of significance to differ users of the information. First, this study is useful to the government in setting regulations that will manage audit firms act with integrity to detect fraud timely and prevent any graft cases. This study will assist in implementing and enforcing the existing policies while formulating new ones.

For those charged with governance, the study identified the non-audit services that influence auditor's quality enabling the management to produce authentic financial statements hence investors, portfolio managers and other market players make the best decisions regarding the investments.

Additionally, the study findings are used to add to the body of knowledge to determine the effect of non-audit service, audit quality on fraudulent financial reporting among firms listed in the NSE from which other researchers can refer to. The academicians who are involved in the accounting research will find the study useful in identifying the gap in the existing research and therefore provide one of the working papers to further their research in accounting on issues dealing with audit quality, audit fees and fraud cases.

Finally, the management of the respective firms will find the information useful to uncover the causes of fraud on financial statements and how quality audit can enhance better services on the financial statement.

### **1.6 Scope of the Study**

The study was conducted in the Republic of Kenya for the period between August 2021 and August 2022 on listed firms in NSE. The study focused on determining the relationship between Non-Audit Services, Audit Quality and Fraudulent Financial Reporting being the major objective. The Audit Quality objective was operationalized by the Auditor Independence, Auditor Tenure and Auditor Opinion on Fraudulent Financial Reporting. The Non-Audit services were operationalized by assurance services, tax advisory services, and management advisory services on fraudulent financial reporting with the target population being 63 firms. A census study was carried out with the appointed internal auditors as the respondents.

### **1.7 Limitations of the Study**

The reliance on primary data by using questionnaires to collect information posed a challenge as the appointed internal auditors were not willing to give full information about fraud cases in relation to non-audit service due to fear of being victimized.

To overcome this limitation, the researcher tried to convince the auditors of the importance of this research that it helps both the government, management and the economy.

## 1.8 Operational definition of key Terms

**Asset misappropriation-**Asset misappropriation is a state where the assets that's have been entrusted in the hands of directors, employees or trustees are stolen thus it's the theft or misuse of funds placed in one's trust or belonging to an employer.

**Assurance Services-** According to the AICPA website, "Assurance Services are defined as 'independent professional services that improve the quality or context of information for decision makers

**Audit independence-** Audit independence is the state of an auditor being free from conditions that may impair his/her ability to carry out an audit in an unbiased manner.

**Audit Independence-** The state of the auditor being unbiased in mental attitude when making decisions throughout the audit process and financial reporting process.

**Audit opinion-** certified opinion by public accountants regarding the audited financial statements of an entity. It is the attestation regarding the fairness of presentation of an entity financial statement.

**Audit Quality-** The degree to which an auditor upholds integrity by being independent despite the audit Tenure, ensuring the correct opinion is issued and avoids being manipulated by conforming to the applicable standards by putting focus on the correctness of information provided in audit reports to eliminate misstatements in the financial statements.

**Audit Tenure-** The length of the auditor-client relationship.

**Fraudulent Financial Reporting** - Fraudulent Financial Reporting can be measured using various indicators such as Asset Misappropriation, Financial statement Fraud, Improper Expense recognition, Overstating Assets, Revenues and Understating liabilities and expenses.

**Management advisory services-** Consulting services provided by an organization to the client on finances and business operations.

**Non-Audit Service** -Non-audit services are consulting services that are provided by audit companies in the aspects fiscal, Tax advisory, Assurance, management, actuarial, international affairs, human resources management, financial investments and others.

**Tax advisory services-** This refers to the provision of knowledge and training on tax laws and tax accounting services. Taxation involves, amongst others, assisting clients to prepare the tax returns and in planning their tax.

## **CHAPTER TWO**

### **LITERATURE REVIEW**

#### **2.1 Introduction**

This chapter outlines the theoretical review of the study, the audit quality and Non audit services, the empirical review and the Conceptual framework.

#### **2.2 Theoretical Review**

A theory is defined as a system of ideas structured in a broad scope and conceived by imagination of human that is made up of a family of empirical laws explaining regulations that exist in events and objects that are either observed and posited (Ittonen, 2010). This study contains several theories that support audit quality, Non audit services versus fraudulent financial reporting where some are based on theory while others are based on beliefs. The Police man theory and Fraud triangle denotes failure as a source of various financial misrepresentations and emphasizes on the theory behind the need for auditing.

##### **2.2.1 Policeman Theory**

The Policeman Theory, initially proposed by Charles F. Hickson in the early 20th century, suggests that auditors act as vigilant overseers, detecting and deterring financial irregularities, fraud, and misstatements in financial reporting. This theory postulates that, the duty of an auditor is to carry out investigation, detection and prevention of fraud in a company thus the rate of competence of the auditor in fraud risk and prevention depends on the financial data`s arithmetical accuracy presented by a company`s management. Recently, the auditor`s responsibilities have drastically changed due to their inability to verify the truth and fairness of the financial statements` figures presented for audit. This theory is related to agency theory due to the fact that an independent auditor would do best to mitigate the agency conflict existing between the delegated managers and the equivalent shareholders (Hayes et al., 1999).

In relation to the study by Meckling (1976), auditing is a monitoring activity that leads to an increase in the firm value. However, if their proposition is correct, then, there was a need for independent auditors to audit managers in the ancient firms as they didn`t provide all share capital. Contrary to Meckling (1976) study, an audit text that went viral recommended that, the aspect of introducing an independent audit is a recent issue that resulted from government dictatorship; “the legislation of the Registered Companies Act of 1862 in England can be seen as one of the first

steps in recognizing the demand for independent audit. The Act requires that the financial statements of public companies be audited by a person independent of management, and thereby strengthened the growth of the profession as well as the status of professional auditors (Zimmerman, 1983).

The work of a policeman is to protect. The theory is applicable in the study since it argues that internal auditors serve as watchdogs for organizations. The expectations of the stakeholders on auditors are for the auditors to protect the assets of the organization against fraud, warn of future insolvency and general reassurance of the well-being of the organization.

### **2.2.2 Fraud Triangle Theory**

This theory was proposed by Cressey (1973) that tried to explain the various factors that lead to fraud and other unethical behavior. The Fraud Triangle theory argued that the offenders of fraud can be sub-grouped into independent businessmen, long term violators and absconders. According to Ewa and Udoayang (2012) the independent businessmen always engage in borrowing after which they keep funds for themselves, on the other end, long term violators engage in borrowing with an aim of protecting families. He denoted that fraud is made up of three factors that are pressure, opportunity and rationalization. Pressure entailed the presence of problems such as lack of money, debts and drug addiction that may not make sense to an outsider but exist with the party facing the pressure. Opportunity on the other hand exists where the party has a chance to commit fraud without being identified while rationalization represents the mindset of the party in justifying why they commit fraud.

Following the principles of the theory, it is brought forward that companies that perform an extensive background check on their workers before engagement suffer less compared to those that do not perform the check. This theory will help firms to detect and do away with criminal or fraudulent actions that may arise in their jurisdiction when such factors arise. This accrues from the theory as the firms will be able to create policies that hinder such fraudulent behaviors.

The theory is applicable to the study in that fraud is significantly reduced by addressing pressure, opportunity and the rationalization. It has become a basis for auditors identifying fraud perpetrators.

## **2.3 Non-Audit Services**

This section discusses the various independent variables under Non-Audit Service on a broader view.

### **2.3.1 Assurance Services**

Assurance Services are defined as 'independent professional services that improve the quality or context of information for decision makers (Zhang et al., 2012) . Audit assurance is essential to an auditee as its mandate is to decrease the risk of internal controls, the risk of misstatement that should eventually lead to a decrease in the possibility of business failure. Audit assurance is also essential to the external users as it reduces the risk of information asymmetry, optimizes allocation of resources that results to the efficiency of capital markets (Kameli et al., 2020).

Assurance services have its main elements in regard to verification of external non-financial reports. These elements include; determination of the level of reliability of the procedures carried out (level of assurance), possibility of making use of an interdisciplinary team of experts, types of verifications and tests to implement, the evaluation of audit risk, suitable reporting criteria, the form of the final assurance statement (Manetti & Becatti, 2009). Sustainability assurance is a state where externals can verify the relevance, reliability and completeness of the sustainable information that has been disclosed by the firm (Boiral et al., 2019). Unlike audit, sustainable assurance services can be provided by other disciplines such as high engineering and consultancy although the audit firms holds a bigger market share (Hodge et al., 2009). Contrary to this, Martínez-Ferrero et al. (2018) asserted that, in order to get a high quality assurance level, its better provided by audit firms as audit firms have dominated in the provision of assurance service market around the world.

### **2.3.2 Tax Audit Services**

Taxation involves amongst others, assisting clients to prepare the tax returns and in planning their tax (Chuenjit, 2014). A tax audit is defined as an official examination of the tax return that the taxpayer is supposed to declare to comply with the tax department law's requirement. There is a difference between audit and tax service. The aim of the audit is to express an opinion regarding the truth and fairness of the financial statements while tax services are provided by the help of tax planners guided by its laws existing to minimize the tax burden of the client. Moreover, a times the same person is appointed as an auditor at the same time to provide

tax service which impairs the objective in expression of opinion or in providing taxation service both at a time (Faniband, 2020).

After the collapse of Enron and WorldCom and their CPA firm, Arthur Anderson, the aspect of rendering non audit services; tax service being part of it, to the same auditor raise eyebrows and its actually an issue to be investigated, especially its fees, by relevant authorities in regards to the CPA independence (Osman, 2016). In Pakistan, the primary purpose of tax audit solutions is to make sure that books of accounts have been maintained in agreement with the provisions of the Government of Pakistan's Federal Board of Revenue Income Tax Ordinance 2001. The clients that undertake tax audit benefit from Tax compliance audit to curb tax evasion and ensures tax compliance, Tax planning audit to improve tax efficiency responsibly and finally Tax risk audit to manage risk and enhance the confidence of individuals or key company stakeholders (RSM, 2017).

### **2.3.3 Management Advisory Services**

Management advisory services are consulting services performed by a specialist organization for its clients. These services are intended to provide advice regarding the operations and finances of clients. The services may address any of the following areas: Asset valuation, Business strategy, Computer systems, Litigation support, Mergers and acquisitions, Organizational structure, Process analysis, Risk management (Bragg et al., 2015). Management Advisory service was also defined as the act of providing professional advisory (consulting) services to improve the client's use of its capabilities and resources to achieve the objectives of the organization. During provision of the services listed, the party in question applies an analytical approach. It further stated that, for one to perform management advisory services, a practitioner must act with at most independence, integrity and objectivity (Rebel, 1988).

Most organizations seek management advisory services from external support on matters of taxation and management strategies. Advisory services help organizations to achieve the set objectives. In the US, the use of advisory services has been embraced especially in the banking sector (Munchus, 1989). Problems experienced small business managers were identified, and it was realized that there was lack of experience and management training, isolation and lack of information, inadequate information system, high debt cost, lack of finance, high labour cost, inflation, staffing difficulties, lack of customers, competition, government regulation, taxation and paperwork burden (Kindström et al., 2024). Johns and Sheehan (1983) urged that, although

managers may possess quality innovation and technical expertise in their field of management, they tend to lack ability to control and conduct overall running of the business successfully as they spread their attention over so many areas. In this regard, they fail to perform thus they must rely on external advice for successful management.

## **2.4 Audit Quality**

This section discusses the various dependent variables under Audit Quality on a broader view.

### **2.4.1 Auditor Independence**

Audit independence is the ability or rather the act of the auditor performing his/her audit duties with integrity and impartiality. It further stipulated that, Audit independence is the existence, and hallmark of the auditing profession. Independence on the other hand is the primary attribute an auditor needs to maintain in all circumstances while Auditor independence falls under the function of the existence of a dispute between the auditor and the client about the treatment of audit reporting issues or issues of fraud and financial misstatements (Akpom & Dimkpah, 2013).

The measurement of the auditor independence is weighed on the level of auditor's honesty when reporting the material misstatements in the financial statements prepared by managers. The manager is entrusted by investors to run the company and maintain it in good state by ensuring growth of the wealth of the investors. The conflict between the investor and the managers arise where the manager chooses to maximize their own interest at the expense of the investor's wealth leading to agency conflict. To curb this situation, the investor decides to bring in an auditor to audit the work done by management. In regard to that, it is the work of the auditor to maintain his/her independence by avoiding any conflicts of interest with the manager and uphold independence provided the audit fees cover the cost of the actual audit. This is of essence as the investors rely on the information given by management regarding the state of the company they are investing in thus auditors have to uphold their independence by verifying the correct managers' assertions in regard to financial statements (Austin & Herath, 2014).

Auditor independence is affected by a practice known as 'Low balling' where the auditor has total trust and overreliance on the client leading to compromise by the auditor (Köhler & Ratzinger-Sakel, 2012). There was increased concern over the quality of auditing of Arthur Andersen when the Chinese audit firm Zhong Tian experienced failure. The increased compromised auditor independence contributed to loss in confidence of investors, audit failures,

and subsequent faltering of big corporations like Enron, WorldCom, and Tyco. The Auditor independence should give room to an auditor to uphold his due diligence without being bias on the client (Du & Stevens, 2013).

Waweru (2018) did a study on audit committee independence and governance in developing nations with the main focus being Kenya. The aim was to determine how Kenyan audit independence relates to those of western nations. The specific focus was on the relationship between audit committees to the organization's internal auditors, external auditors, and how they relate to the management. The other issue was to determine the challenges faced by most Kenyan auditors while performing their professional standards on auditor's independence. It was concluded that only minimal differences exist although there is much political influence. The study also noted that most auditors had close relationships with enterprise management which would impact on the financial reporting.

In Kenya, an audit committee was established in 2000 with the aim of ensuring there is objectivity, integrity and independence. Kibet (2008) outlined the need to ensure audit independence among the audit committees in Kenya. The committee has the oversight responsibility to ensure the audit is done by the set guidelines. The study concluded on four roles that audit committees need to play to ensure effective audit independence. One role is to ensure external financial reporting to ensure the audit reports are done in accordance with set principles and standards. The other role is internal control, and this shows any existing frauds in audit reports. The third role is to determine a risk management system in terms of the risk mitigation strategies available. The final role is to coordinate internal and external audit, and this involves ensuring audit independence is followed.

#### **2.4.2 Auditor Tenure**

Audit firm tenure is the duration of time that an audit firm has audited a particular client. The extended relationship (Tenure) between the client and audit firm can threaten the auditors' independence due to familiarity with the client (Primadita et al., 2021). Audit tenure has a negative relationship with audit quality. In regard to that, the longer the relationship between the client and the auditor, the lower the audit quality and that firm size insignificantly affects audit quality (Al-Thuneibat et al., 2011). An Audit Tenure can either be voluntarily or mandated and this change can affect the quality of audit to a higher extent. The costs associated with Audit tenure may include costs related to tender placement process, transition of client and auditor activities, and the

client-specific learning curve facing the auditor (Bell et al., 2015). Imeokparia (2014) added further on the costs associated to audit rotation and they included: lower audit firms competition, expensive clients internal costs, capacity constraints and scheduling problems, shifting focus and effort towards preparation of proposals for new engagements, lower incentives to invest in specialization and higher audit fees.

When the audit tenure takes too long, it affects the quality of audit as the knowledge of the client may depreciate when the client performs the same duties continuously. The auditor may compromise his independence when they over rely on the client for their monthly pays, and this can make the auditor compromise on their independence. The Regulators on Audit issues after conducting research on audit quality versus Non-audit services found out that the aspect of interaction between the auditor and the client creates a strong bond that leads to long audit tenure. The long audit tenure affects the auditor's professional skepticism and leads to compromising. On the other hand, the economic bonding from monthly dues in the aspect of non-audit fees makes the auditor harken to management's financial reporting demands instead of upholding integrity and independence (Gipper et al., 2017).

Several studies have been documented to show the effect of audit tenure in auditing under Kenyan cases. Agunda (2014) did a study to document the evidence of the effect that audit tenure has on audit quality in commercial banks in Kenya. Multiple regression analysis was used with the independent variables being audit rotation, audit fees and consultancy services. The dependent variable was audit quality. 43 commercial banks were used as the study population and the data was collected using questionnaires. The study concluded that offering audit services on a rotational basis makes audit quality high compared to long-term tenures. The scholar argues on the need to reduce audit tenure if the quality was to be obtained.

Another study by Odanga (2016) did a study on the effect of audit tenure, client importance and auditor reputation on audit quality in Kenya. The study divided audit firms into big firms and non-big audit firms. The researchers wanted to determine whether bond price was included in credit rating and if the choice of audit firm affects the credit spread. It was concluded that when evaluating bond ratings, the auditor's characteristics were put into consideration and that of the non-big audit firms got a downgrade by one minor rating category. Companies who had maintained long tenure with the audit firms were rated based on their bond while those with large audit firms

got a premium on their bonds. The study concluded that audit tenure has an impact on audit quality under the capital market.

### **2.4.3 Auditor Opinion**

Audit opinion refers to a certified public accountant's opinion regarding the audited financial statements of an entity. It is a written attestation as to the fairness of presentation of financial statements. An audit opinion influences financial reporting significantly, as it leads to timely financial reporting (Shukeri & Nelson, 2011). Generally, there are four types of audit opinions: unqualified, qualified, disclaimer and adverse opinion. An unqualified opinion is a clean opinion meaning that the financial statements appear to be presented fairly. In other words, firms with unqualified audit reports have less problems in financial reports that decrease the time spent by the auditors to complete their audit task. Qualified opinion means there is bad news in that, the information provided was limited in scope and/or the company being audited has not maintained generally accepted accounting principles leading to declaration of reporting process (Türel, 2010).

According to Shukeri and Nelson (2011) they postulated that, those firms where the auditor reports unqualified opinion are in most cases associated with good management and sound internal control that leads to less audit time. Disclaimer opinion is the auditor's statement disclaiming any opinion regarding the company's financial condition due to an inability to gather certain relevant facts. Adverse opinion is one which states that the financial statements do not fairly present the financial position of the company or that it is not in accordance with generally accepted. Ismail et al. (2012) argue that audit lags are likely to be associated with audit opinions and that qualified audit opinions are always issued later than unqualified opinions.

## **2.5. Fraudulent Financial Reporting**

This section discusses the various independent variables under Fraudulent Financial Reporting on a broader view.

### **2.5.1 Asset Misappropriation Review**

Fraud is a deliberate deception to obtain illicit material gain, and includes embezzlement and asset misappropriation (Pan et al., 2011). Management can overstate its assets or revenues or understate liabilities or expenses. Wells (2017) believes that it is carried out through fictitious revenues, timing difference, improper asset valuation concealed liabilities and expenses and improper or inadequate disclosure. Employee fraud can also be driven through illegal transfer of

funds and assets, false balance crediting, opening, use and management of fictional accounts, claiming of overtime for hours not worked, fund diversion ( tapping funds from interest into a suspense account) computer fraud via compromising login credentials of an e-banking user (Adeyemo, 2012). There is an increased focus on sound asset management due to recognition of its value to an organization (El-Akruti & Dwight, 2013). Assets in an organization are guarded against misappropriation because of the resultant negative impact on the organization which affects the organization's value and its corporate credibility (Song et al., 2013).

Employee fraud is mainly associated with asset misappropriation, and this is mainly by stealing assets or putting false billing on the selected assets. Such misappropriation can be divided into two categories namely; theft of cash items and theft of cash items (Kazemian et al., 2019). The act is done by employees who are good at billing assets in a manner that is hard to detect. Books of accounts are corrupted to hide shortages and discrepancies. According to ACFE, asset misappropriation can be classified into seven main groups namely; register reimbursement, expense reimbursement, billing, payroll, cash larceny, skimming, and check tampering. Kazemian et al. (2019) gives opportunities that lead to an increase in asset misappropriation which includes a weak control system, absence of management, poor separation of duties and inadequate supervision. The study also argued that most companies unwisely provide opportunities for their employees to engage in fraud activities.

A review conducted by PWC in 2020 found out that asset misappropriation is the most reported economic crime in Kenya. Other crimes identified are accounting frauds and corruption and bribe rates. The report also identified Kenya as a country with the highest rate of white-collar crimes among the 78 countries involved. Asset misappropriation was also high in Kenya compared to the 78 nations studied. A study by Besada and O'Bright (2020) states that Kenya lost 5.5 billion in 2020. Some of the main areas of corporate Kenya include bribery and corruption (14%), customer fraud (12%), asset misappropriation (12%), procurement fraud (15%), money laundering (12%), and customer fraud (12%). The crimes were facilitated by internal staff, middle management and senior management staff. Pressure was also found to have a correlation with asset misappropriation in government institutions. Other factors include the ability of an employee to justify their wrong act when caught in asset misappropriation fraud (Kazemian et al., 2019). The study also found out that the ability to convince other staff to corporate frauds may make insider staff engage in such activities.

In Kenya, with the existing system of checks and balances, asset misappropriation fraud is on the rise compared to other countries in East Africa. The high cases of fraud of asset misappropriation affects the performance (Opiyo, 2017). A study by Gikiri (2012) determined the effect of fraud risk management in Kenyan commercial banks. Asset misappropriation was included in the objective to determine how commercial banks put on measures to reduce such risks. It was revealed that information sharing is crucial in reducing such crimes in the banks.

### **2.5.2 Improper Expense Recognition Review**

Auditors provide assurance that financial statements presented on expense recognition are free from misstatement. Auditing financial statements in terms of the quality assertion versus the specific criteria is the end result of an auditors opinions on financial statements provided on the company's expenses (Dechow et al., 2011). The auditor's opinion can be affected by expense statements of errors and fraud. According to Asare and Wright (2004) risk and assessment level in the audit environment influences audit strategy establishment that can provide a reasonable way of detecting miserable misstatements in the financial statements presented. Eilifsen and Messier Jr (2000) found an association between risk and uncertainty in relation to financial statements presented on expense recognition.

A study by Mwangi (2020) recorded that Deloitte Kenya found CMC motors financial statements as having improper expense recognition. The company's financial statements did not recognize losses from CMC losses from damaged assets. In addition, booking of undelivered vehicle sales were not regarded as revenues and interest payment sold cars on credit were not recognized. A final report by CMC operators in 2010 found out that financial statements presented by CMC accountants were not in relation to the set international financial reporting standards. The issue raises a question of the level at which auditors notice improper expenses statements in financial statement reporting. These CMC statements raise a question to the stakeholders as they weigh the level of expenses that are recognized in the financial statements.

### **2.6 Empirical Studies**

These are past studies done by different scholars to build more knowledge in this topic and prevent duplication of research work. Empirical studies are past studies that have been done by different scholars in different countries and different fields of studies. Each scholar uses different variables in the studies. These studies are as discussed below:

## **2.6.1 Non -Audit Services and Fraudulent Financial Reporting**

### **2.6.1.1 Tax Advisory Services and Fraudulent Financial Reporting**

Graham et al. (2014) examined company's incentives and disincentives through tax avoidance. The main objective was to determine the managers' willingness to ask tax executives about tax planning strategies and their effects on their incentives in New York. The researchers conducted a survey where they interviewed a sample of 600 corporate tax executives. They performed the survey by emailing the set of questions to the various corporate tax executives. They found out that, Tax systems play a crucial role in audit services. Tax practitioners and tax authorities play a crucial role in determining tax reforms in a nation. They concluded that reputation, cash tax payment, and earnings per share, and financial accounting incentives are some of the key factors that make companies fail to adopt tax advisory services.

According to Francis et al. (2014), they conducted a study on the impact of CFO gender on the level of corporate tax aggressiveness in Finland. They mainly focused on firms that experience a transition of male to female CFO. Their main objective was to investigate how permanent book-tax references were used to determine tax aggressiveness. The researchers conducted a survey in 1500 public companies. They used secondary data by deriving the data from ExecuComp and SEC Edgar database. The study concluded that female counterparts had less tax aggressiveness compared to male partners. The study found out that institutions run by female leaders are likely to enquire for tax advisory services than those run and operated by women.

Atwood et al. (2012) conducted a study on Home Country Tax System Characteristics and Corporate Tax Avoidance: A case study of Worldwide verses Territorial approach (US). The main objective was to investigate the impact of tax system characteristics on corporate tax avoidance. According to the researchers, tax system characteristics have an impact on corporate tax avoidance and Tax advisory services help to understand more regarding tax system characteristics. This also determines the extent to which management compensation comes from variable pay, including bonuses, stock awards, and stock options. They considered a sample size of more than 69000 firm year observations from 22 countries. They used a secondary source of data. The study concluded that the rate of tax avoidance is low if there is high book-tax conformity and that the extent of tax avoidance depends on the level of management variable compensation from stocks, stock options and bonuses. The impact is different among nations and may be altered by the specific country's

tax reforms. Thus, Trust can only be developed by having firms that offer efficient tax advisory services based on set principles of a country.

Omondi and Theuri (2019) conducted a study on the impact of tax audit on tax compliance: A case study of small-scale traders in Nakuru county Kenya. The main objective was to investigate the effects of tax awareness and cost of compliance on tax compliance. The study revealed a positive correlation between tax auditing and tax compliance. The study used descriptive research design where a sample size of 302 was drawn from a population of 1416 small scale traders that were licensed. Data was collected using questionnaires and later analyzed using regression techniques. Findings showed that, the low tax compliance level of most Kenyan institutions portrayed a lack of quality auditing on tax reports. Other factors that were found to influence compliance include penalties and enforcement and perception on government spending. Most firms liaise with audit firms to engage in tax reforms through corruption mechanisms.

#### **2.6.1.2 Management Advisory Service and Fraudulent Financial Reporting**

Kent (2011) carried out a study on the decisions to outsource management advisory services: A case study of listed companies in Australia. The researcher used transaction cost economics as a theoretical framework. Their main objective was to investigate companies' decision to purchase Management Advisory Services from their external auditors other than from within the company. Secondary data was used as an instrument of data collection by sampling annual reports of 3154 listed companies in Australia. They also surveyed the listed companies and used ordinary least square regression for data analysis. The findings showed that there were several factors that were associated with external purchase of MAS. This include; number of restructuring controlled entities/subsidiaries, number of geographical segments, management change and contracting frequency, membership of company in the industry, Return on assets, leverage, short term growth, type of audit report, audit fees and use of big 5 auditors. They concluded that, the factors mentioned are the determinants for purchasing MAS and other consultancies externally.

Rigsby et al. (1998) examined the relationship between mentoring and rapid organizational Change; Case study of two international accounting firms that was merging. The main objective was to determine mentoring as a resource for coping with Organizational change. Questionnaire was used as a means of data collection instrument and considered grounded methodology theory. A sample size of 28 was used with respondents being NAS professionals both seniors and managers in the merged firms. Results showed that, a formal mentoring system was highly used

by the two firms. Findings showed that, self-esteem and confirmation of mergers process was triggered by psycho-social function. In addition, Management was not able to provide the structure and direction that the formal mentors needed hence a large increase in the fear and distrust of the formal mentors and top management. It concluded that, the organizational culture of the firm plays a very important role in determining the adaptive response of participants in mentoring during a merger.

### **2.6.1.3 Assurance Services and Fraudulent Financial Reporting**

Martínez-Ferrero et al. (2018) conducted a study to examine the quality of sustainability assurance reports: A case study of listed Companies in 17 different countries which were Germany, Belgium, Canada, Spain, France, Hong Kong, India, Italy, Japan, the Netherlands, Denmark, Finland, Norway, Sweden, Switzerland, the UK and the USA. A secondary source of data from the database was used with a sample size of 242. The variables used were the expertise and experience level of the practitioner while the main objective was to evaluate the impact of assurance provider's expertise and experience in relation to assurance quality. Findings showed that, in order to get a high-quality assurance level, its better provided by audit firms as audit firms have dominated in the provision of assurance service market around the world thus, they have the required expertise in this area. In addition to auditors, accounting firms can also undertake assurance services as they possess adequate skills having trained within the audit profession.

Fuhrmann et al. (2017) examined the contents of assurance statements for sustainability reports and information: A Case study of Large, medium and small capitalized listed companies in European countries. The main objective was to analyze the relationship between the design of the assurance process for sustainability reports and the level of information asymmetry between companies and their stakeholders. For data collection, Primary data was used by hand collecting information from key stakeholders while secondary data tool was used by analyzing data from the past company's data base. The sample size was 600 and descriptive design was used to analyze the data. Findings showed that high assurance level reports are highly appreciated by users as they are highly credible as per numerical data test hence reduces information asymmetry between companies and their stakeholders. They concluded that, companies that engage non-big 4 to provide assurance services should always research on the scope and tests of details of numerical data and a description of the sustainability assurance-specific work steps. This ensures that sustainability reports are credible and reduces the information asymmetry. Furthermore, the

provider's competencies should also be checked as it helps to reduce the information asymmetry as it enhances credibility.

Michelon et al. (2019) conducted a study on Legitimacy for sustainability Assurance. A case study of US firms. The main objective was the relationship between market share and assurance providers in a new market space. A sample size of 500 firms was used with secondary data as a tool of data collection. Descriptive survey was used in the study. Findings showed that SRA is associated with an increase in the likelihood of sustainability restatements. This relationship is stronger when it comes to error restatements than for restatements due to methodological updates. SRA is also positively related to the disclosure of quantitative non-material restatements. In addition, consultant assurance is associated with methodological restatements and restatements of a non-material amount. The study concluded that there are differences between sustainability report restatements and financial restatements and that providers of assurance services may be using restatements in order to expand the market share in a new professional space.

### **2.6.2 Non-Audit Services and Audit Quality**

Mwando (2012) conducted a study on related diversification, as a strategic orientation among mid-tier audit firms in Kenya. In his study, he used a descriptive survey design. The population selected was 700 audit firms registered by the ICPAK and a sample of 70 firms were selected for the study using convenience-sampling method. The research considered Primary data collected using semi-structured questionnaires administered through drop and pick later method. Data was analyzed using descriptive statistics supported by SPSS. The study found out that, all the firms had adopted related diversification strategy in that; Other than the audit business, all the firms had diversified into taxation services by offering company secretarial services, consulting services, and accounting services. The study concludes that all the audit firms had adopted related diversification strategy where related non-audit services such as taxation services, company secretarial services, consulting services and accounting services were provided as an SBU or as a non-strategic business unit. The study also concludes that related diversification led to growth of audit firms as majority of respondents agreed. The study recommends that there is need for mid-tier audit firms to diversify more into business advisory services to complement the audit business as this is important in stabilizing the earnings from these firms. The study also recommends that

mid-tier audit firms should rigorously exploit their potential in offering these non-audit services to improve their contribution to overall revenues of these firms.

Okoye and Adeniyi (2016) carried out a study on the topic of Effects of Auditor Tenure and Non-Audit Services on Auditors Negligence: a case study of audit firms in Nigeria. The study used a descriptive survey design with Business analysts, Investors and academicians being the target respondents. The study considered a sample size of 115 respondents who were administered with questionnaires. Analysis of variance (ANOVA) and SPSS were used to analyze the data and in testing the hypothesis consecutively. The researchers used three sets of objectives, one of them being to ascertain whether audit tenure influences audit negligence. Findings showed that auditors go for all services given that they are accompanied by engagement letters. Also, a longer auditor tenure contributes to auditor negligence. He stressed that, independence of auditors is only impaired when they take the role of preparing financial statements, yet they are not qualified as accountants. They concluded and recommended that, Accounting and Auditing as profession should formulate a policy that regulates auditors carrying out NAS services and urged the auditors to lay their interests aside and operate as per the requirements of auditor's professional code of practice that considers the clients.

A study conducted by Hohenfels and Quick (2020) on the effects on Non Audit services and Audit Quality in Nigeria contributes to this literature. The study considered a sample size of 2567 respondents from firms listed in Germany. The main variable under study was Earnings management used as an audit quality measure. Findings showed that, Audit fees and Audit quality are negatively related in that, if the NAS fees increase, the quality of audit decreases. In addition, Non-Audit services cannot be done separately such as assurance and consultancy as they affect audit quality negatively although Tax services doesn't affect the quality of audit at all. In conclusion, imposing a higher capping rate on NAS fees still leads to deterioration of audit quality but setting it at a moderate level has no bigger effect on the audit quality.

Kang et al. (2019) carried out a study on the topic; Non-Audit services and Auditor independence depending on client performance; a case study of Listed companies in Korea. The study selected 4511 sample size from a population of 20954 listed companies in Korea. The study used Ordinary least square regression analysis to test the hypothesis. They found out that, as non-audit fees in Korea increase, auditor independence is reduced only for low performing audit clients. That auditors fail to adhere to accounting practices when earnings management incentives are

increased therefore compromising their independence. They concluded that it is unnecessary to prohibit NAS instead, regulators and policy makers should examine the motivation for purchasing NAS particularly among audit clients with poor performance.

Sharma and Sidhu (2001) in their study on Non Audit services and Audit Independence; a case study of bankrupt public companies listed in stock exchange in Australia. The study settled on a sample size of 49 and used descriptive statistics method. Findings denoted that, higher non-audit service fees to total audit fees influenced audit opinion in terms of the going concern. They further explained that synergies of knowledge spillover and audit efficiency arise from providing both audit and non-audit services.

De Simone et al. (2015) in their study on NAS denoted that, Tax advisory services creates awareness to the auditor on significant transactions made earlier in the year. This helps the auditor get a better understanding of complex issues in accounting in terms of income taxes always the last phase of the audit engagement, thus leading to timely audit completion. Regarding this, firm managers who purchase NAS will gain confidence in the financial statements thus will lead to timely earnings announcements, and at the same time, announce earnings when the audit is more complete.

### **2.6.3 Audit Quality and Fraudulent Financial Reporting**

Kwabena (2017) conducted a study on the effects of internal audit quality on financial performance where the researched considered a case study Firms listed in Nairobi security exchange in Kenya. The study used primary data by employing questionnaires and secondary data from the audited and published financial statements of firms under study. The study employed a descriptive research design and sampled all the firms listed in NSE. Findings showed that, internal and external auditors have the duty of detecting financial fraud in an organization. Financial fraud detection is determined by the auditor's proficiency. The greater the skills, integrity and expert ability the more quality auditing will be provided. The evidence showed that huge and specialist auditors are associated with audit quality. Their study further observed that users of the big five audit firms in Kenya have fewer financial fraud compared to those getting services from inexperienced audit firms.

Jonathan (2014) conducted a study on the relationship between audit quality and corporate governance on commercial banks in Kenya. The main objective was on the effect of internal auditor independence on corporate governance. Primary data was considered by administering the

set of questionnaires to the settled sample size of 43 commercial banks in Kenya. Regression method was used to test the hypothesis after descriptive analysis aided by SPSS software. The study found out that the chief executive officers have the duty of determining the internal audit spending plan, audit quality on financial statements was altered through auditor's independence. In addition, the study found a connection between corporate governance and audit quality in organizations.

Gilbert et al. (2019) carried out a study on Effect of Financial Misstatement and Corruption on Fraud Risk; a case study of State Corporations in Mombasa County in Kenya. The aim of the study was to evaluate the effect of financial misstatement and corruption on fraud risk among state corporations. During the study, a sample of 64 respondents was used. The study considered fraud triangle theory to support the study. The study used a descriptive research design with primary data collected via questionnaires. The findings showed that there was a positive relationship among the variables. The study gave a recommendation for the adoption of policies to handle financial statements like forensic accounting and auditing.

According to Modugu and Anyaduba (2013) in their study on Forensic accounting and financial fraud: a case study of listed companies in Nigeria. The main objective of the study was on the effects of forensic accounting and financial fraud in Nigeria. A sample size of 143 was selected by simple random technique. The questionnaires were administered to accountants, shareholders, management and the practicing auditors being the respondents under study. The data was collected and analyzed by binomial test technique. The study listed a variety of financial fraud such as bribe cronyism, nepotism, political donation, kickbacks, artificial pricing and fraud of all kinds. Findings showed that, forensic accounting positively affected control of fraud, internal audit and financial reporting. The study recommended a specialization in the field of forensic accounting for academicians and further stated that the government should encourage investigation and monitoring where there is corruption.

## **2.7 Summary of Literature and research gaps**

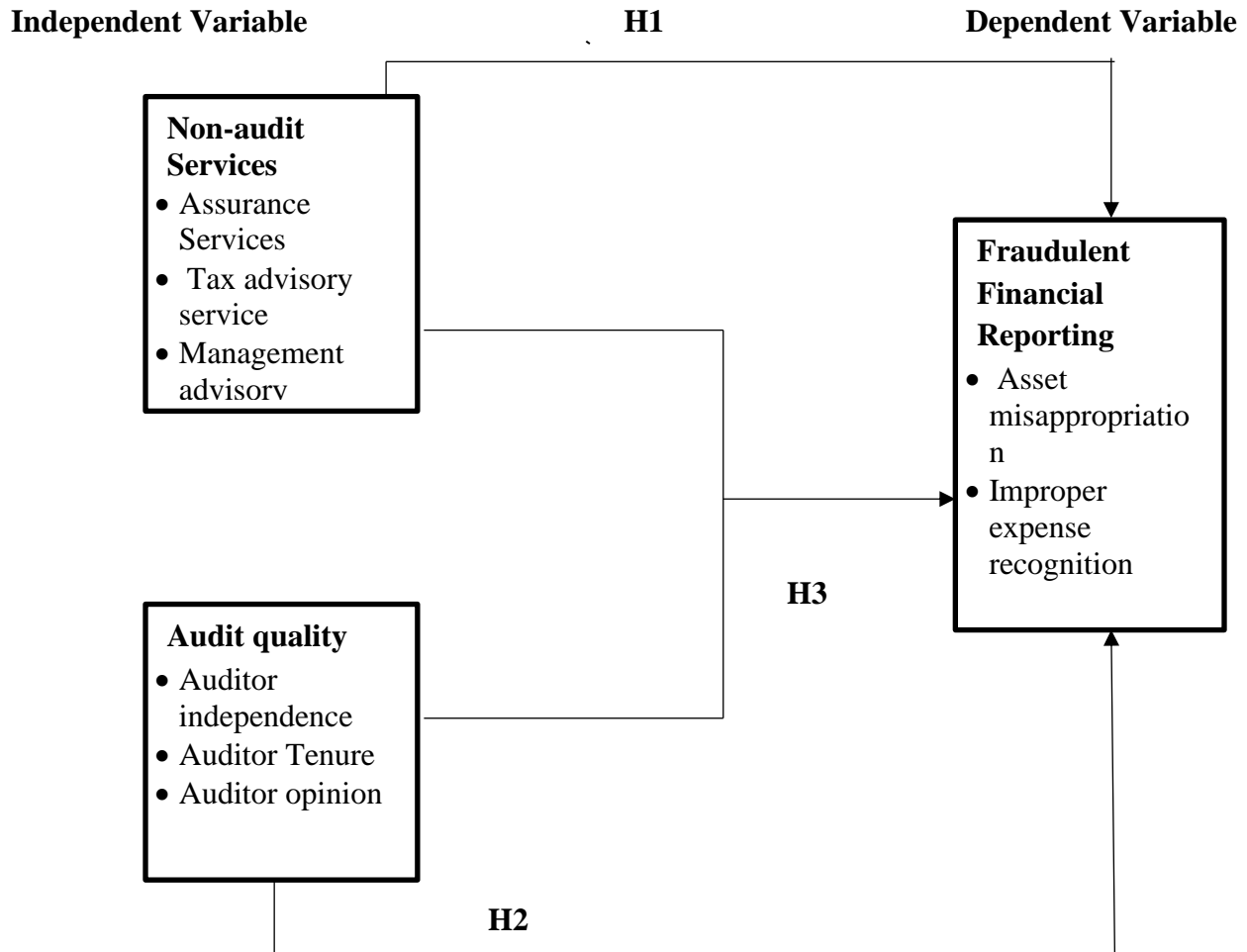
The literature review has identified different variables and theories that will be used in the study of the relationship between Non-Audit services, Audit Quality and Fraudulent Financial Reporting among firms listed in NSE. Previous studies done were carried out in various sectors such as Financial, Agricultural, Institutions and Parastatals among others. Despite these, there still exists research gaps as per the study observed. Waweru (2018) did a study on audit committee

independence and governance in developing nations with the main focus being Kenya and he concluded that only minimal differences exist although there is much political influence. The study also noted that most auditors had close relationships with enterprise management which would impact on the financial reporting. This study is different from the study of Waweru since it will focus on Non-audit Service on Fraudulent Financial Reporting, Audit quality and Non-audit service on Audit quality and not audit committee alone.

Agunda (2014) did a study to document the evidence of the effect that audit tenure has on audit quality in commercial banks in Kenya. The study concluded that offering audit services on a rotational basis makes audit quality high compared to long-term tenures. The scholar argues on the need to reduce audit tenure if the quality was to be obtained links financial fraud with corporate governance (Magnanelli et al., 2017). The study found out that financial fraud is higher when governance is not well represented. The author also added mechanisms that can curb financial fraud in an institution, some of the selected controls include setting audit committees and developing internal audit positions. It is based on this finding that this study sort to assess the relationship between Non-Audit Services, Audit Quality, and Fraudulent Financial Reporting among listed firms in NSE.

## 2.8 Conceptual Framework

The conceptual framework shown in figure 2.1 below represents the relationship between non-audit Services, audit quality and Fraudulent Financial reporting of firm listed on the NSE in Kenya



**Figure 2.1 Conceptual Framework**

The main objective was to determine the relationship between Non Audit Services and Audit Quality as the independent variable and Fraudulent Financial Reporting being the dependent variable. The Non-Audit was operationalized into Assurance Services, Tax Audit Services, and Management Services. Audit quality on the other hand was operationalized into Auditor Independence, Auditor Tenure and Auditor Opinion. Fraudulent Financial reporting being the dependent variable in this study was operationalized into Asset Misappropriation and Improper expense recognition. These variables helped to conduct the study among listed firms in NSE being key in determining the state of the economy and the country at large.

## **CHAPTER THREE**

### **RESEARCH METHODOLOGY**

#### **3.1 Introduction**

This chapter presents the research design and methodology of the study. It spells out the techniques and methods of data sampling, collection, processing and analysis.

#### **3.2 Research Design**

The research was conducted using a descriptive research design which gives a description of phenomenon, characteristics and association of the research variables. The research design was appropriate for this study as it enabled high level analysis such as correlation and regression analysis that allowed establishing non-audit services, audit quality, and Fraudulent Financial Reporting among firms listed in NSE. The study employed the use of questionnaire to collect data that showed facts on establishing non-audit services, audit quality, and Fraudulent Financial Reporting.

#### **3.3 Target Population**

The population for this study comprised of listed firms in NSE. The total number of listed firms in NSE was 63 as outlined in Appendix II. The study targeted the appointed internal auditors in every firm listed in NSE which are situated in Nairobi County. The appointed internal auditors were the suitable respondents under study as they audit the books of accounts and issue an opinion regarding its status that is always critical when shareholders and public are making decisions.

#### **3.4 Census Survey**

Census survey is the appropriate data collection design for a small heterogeneous population. Since the target population is small and heterogeneous, census survey was adopted where the 57 listed firms in NSE were studied and 6 used for piloting. According to Kothari (2014) the larger the sample size for a small population, the more accurate the results are likely to be and hence the choice of the census technique in the proposed study.

#### **3.5 Data Collection Instruments**

The main instrument of data collection was open-ended questionnaires to obtain primary data. The researcher used the drop and pick method for easy administration. A five point Likert scale, ranging from strongly agree to strongly disagree was used to measure the importance the respondents are attached to the independent variables (Brace et al., 2012). The questionnaire had

nine sections A- I. A was to examine the demographic data while B-I was to be used to collect data on the study variables.

### **3.6 Validity and Reliability of the Research Instruments**

#### **3.6.1 Validity of the Research Instruments**

According to McMillan and Schumacher (2001) validity is quality attributed to proposition or measures of the degree to which they conform to establish knowledge or truth. For the questionnaires to accurately measure what it is supposed to measure, the questionnaires must have content and construct validity. In this study, for construct validity, the questionnaire was divided into sections to ensure that each section assesses information for a specific objective, and also ensured that the same closely ties to the conceptual framework. To ensure content validity, the questionnaire was subjected to thorough examination by supervisor, finance and evaluation experts in the field of capital budgeting decisions and its application. They were requested to evaluate the statements in the questionnaire for relevance and whether they were meaningful. The questionnaire was adjusted appropriately before the final data collection exercise began. The comments were used to ensure the content validity was obtained.

#### **3.6.2 Reliability of the Research Instruments**

Reliability refers to the consistency, stability and repeatability of results that is the result of a researcher is considered reliable if consistent results have been obtained in identical situations but different circumstances (Golafshani, 2015). The Cronbach alpha test was used to measure the consistency of the items in the questionnaire. Cronbach alpha has the most utility for multi-item scales at the interval level of measurement, requires only a single administration and provides a unique, quantitative estimate of the internal consistency of a scale (Sekaran & Bougie, 2019).

The study conducted a pilot study from 6 listed companies in Nairobi purely for feasibility test only. The 6 firms out of the target population of 63 that were used for piloting were excluded from the actual data collection. The size of a sample to be used for pilot testing varies depending on time, costs and practicality but the same would tend to be at least 10% of the target population, hence the size of 6 was the most suitable (Sekaran & Bougie, 2019). For this study, the alpha coefficient for the sample was at 0.70.

### **3.7 Data Collection Procedure**

Prior to data collection, the researcher sought the letter of consent from Egerton University and permission from NACOSTI to obtain a research permit. Each firm was issued with one

questionnaire to be dropped and picked at workplace. The researcher targeted the appointed internal auditor, hence a total of 57 questionnaires were issued during data collection. The main reason for choosing these target respondents is because auditors audit the books of accounts and issue an opinion that is always critical when shareholders and general public are making decisions.

**3.8 Data Analysis and Presentation**

The study used quantitative methods to analyze data. The information was codified and entered a spread sheet and analyzed using SPSS (Version 21). Quantitative data was analyzed using descriptive statistical method: statistical tools such as mean, mode and standard deviation were used. Inferential statistics such as simple and multiple regression models were used to predict the relationships. Tables and bar charts were used to present the data for easy understanding and analysis. The study adopted regression analysis to estimate the causal relationships in the study. SPSS version 21 software was used for analysis purposes. Multiple regression analysis was used to test the hypothesis and it was tested at 5% significance level.

**3.8.1 Model Specification**

The study had three objectives. Multiple regression was used to operationalize the objectives. The first objective was to establish the effect of non-audit service on fraudulent financial reporting among listed firms in NSE. The linear regression was as indicated below:

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \epsilon \dots\dots\dots 3.1$$

Where;

Y = Fraudulent Financial Reporting

$\beta_0$  = Constant

$\beta_1, \beta_2$  and  $\beta_3$  = Variable Coefficient

$X_1$  = Assurance Services

$X_2$  = Tax advisory service

$X_3$  = Management advisory services

$\epsilon$  = Error term

The second objective was to determine the effect audit quality on fraudulent financial reporting among listed firms in NSE. The linear regression was as indicated below:

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \epsilon \dots\dots\dots 3.2$$

Where;

Y= Fraudulent Financial Reporting

$\beta_0$  = Constant

$\beta_1, \beta_2, \beta_3$  = Variable Coefficient

$x_1$  = Auditor independence

$x_2$  = Auditor Tenure

$x_3$  = Auditor opinion

$\varepsilon$  = Error term

The third objective was to determine the joint effect of non audit service and audit quality on fraudulent financial reporting among listed firms in NSE.

$$Y = \beta_0 + \beta_1 x_1 + \beta_2 x_2 + \varepsilon \dots\dots\dots 3.4$$

Where;

Y = Fraudulent Financial Reporting

$\beta_0$  = Constant

$\beta_1, \beta_2$  = Variable Coefficients

$x_1$  = Non audit service

$x_2$  = Audit Quality

$\varepsilon$  = Error term

### 3.9 Diagnostic Test

The study conducted the diagnostic test by determining the multicollinearity, normality and the linearity of the study variables.

#### 3.9.1 Multicollinearity Test

The multicollinearity test was conducted to ascertain the relationship that exists among the independent variables which in this case was Non Audit Services and Audit Quality. The model was tested for both the tolerance limits (TL) and the variance of inflation factor (VIF) among the independent variables using a correlation matrix. From the matrix if the value of tolerance is found to be less than 0.1 and simultaneously the value of VIF is 10 and above, then there is high association among the independent variables connoting the existence of multicollinearity (Daoud, 2017).

#### 3.9.2 Linearity Test

A linearity test was conducted on the study variables to ascertain whether the independent variables (Non Audit service and Audit Quality) in the regression have a straight-line relationship with the dependent variable (Fraudulent Financial Reporting). The study used scatter plots to

determine the linearity. The linearity test was used to measure the association between Non Audit services, Audit Quality and Fraudulent Financial Reporting so as to predict the dependent variable by the independent variables (Kumari & Yadav, 2018).

### **3.9.3 Normality Test**

The study carried out normality tests. This was to determine the modeling of the collected data for valid inferencing from the regression. Valid inferences mean the residuals of the regression follows a normal distribution. The study used the graphical method approach of comparing the histogram of a sample data with a normal probability curve (Sander et al., 2016).

## CHAPTER FOUR

### RESULTS AND DISCUSSION

#### 4.1 Introduction

This chapter entails the results and discussions as per the objectives of the study. It also contains descriptive analysis, inferential statistics, hypothesis testing. Descriptive analysis included the percentage and frequency. Inferential statistics entails correlation and multiple regression model.

#### 4.2 Response Rate

The study had a population of 57 firms listed on the NSE. The respondents of the study comprised of 57 internal auditors and 57 of the auditors completed and returned the duly filled questionnaire, which was a response rate of 100%. This was acceptable and adequate response rate. According to Mugenda and Mugenda (2003) a response rate of 50% is adequate for analysis and reporting; a rate of 60% is good and a response rate of 70% and over is excellent. The questionnaire's return rate results are shown in the Table 4.1.

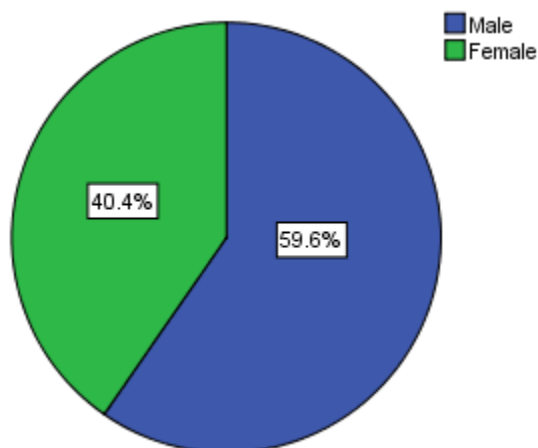
**Table 4.1 Response Rate**

No. of questionnaires Issued	No. of questionnaires Returned	% Response rate
57	57	100%

#### 4.3 Demographic Information

The study assessed the gender of the respondents. The findings are summarized below.

##### 4.3.1 Gender



### Figure 4.1 Gender of the Respondents

The study assessed the gender of the respondents. The findings are summarized in figure 4.1. Fifty nine point six percent (59.6%) of the respondents were male forty point four percent (40.4%) of the respondents were female. The findings implied that most of the respondents who participated in this study are male compared to female employees. However, this is a fair representation of gender in the listed firms.

### 4.3.2 Years of Service

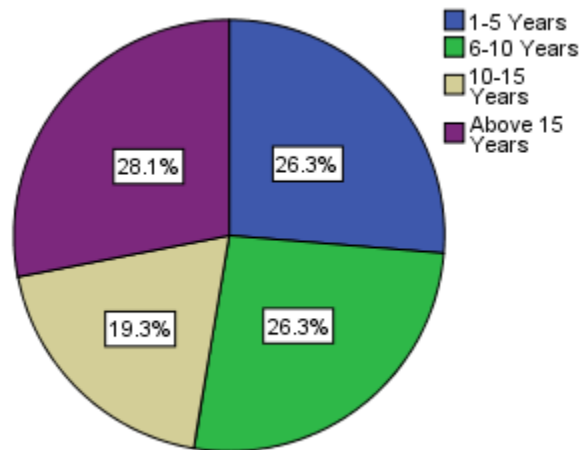
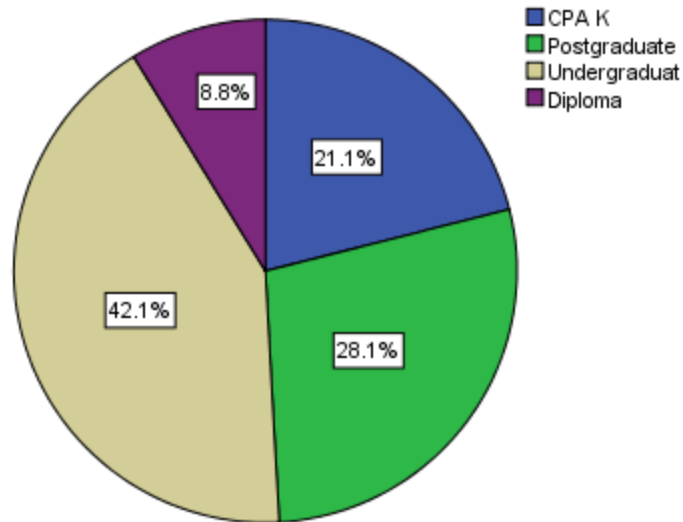


Figure 4.2 Number of years of experience in audit field

In figure 4.2 the study assessed the number of years of experience in audit field, twenty six point three percent (26.3%) depicted 1-5 years, the same percentage also depicted 6 to 10 years while nineteen point three percent (19.3%) of the respondents have worked for 10 to 15 years and twenty eight point one percent (28.1%) of the respondents have worked for more than 15 years, The findings implies that most respondents have worked above 15 years. The period is adequate for the research as the respondents have enough knowledge to provide the required responses to the questions under study.

### 4.3.3 Level of Education

The respondents were asked to indicate their highest level of education. The findings are indicated in figure 4.3.



**Figure 4.3 Education level**

From figure 4.3; twenty-one-point one percent (21.1%) of the respondents were CPA K holders. The study also revealed that twenty-eight-point one percent (28.1%) of the respondent had postgraduate qualification while forty-two-point one percent (42.1%) of the respondents had undergraduate qualification and eight-point eight percent (8.8%) of the respondents were diploma holders. The findings revealed that most respondents have attained undergraduate level of education. This implies that the respondents are knowledgeable enough on the questions being asked and therefore provided effective responses. This could also imply that listed firms value education among the staff and with proper education the staff are able to deliver on the objectives of the organizations as well as increase accountability among the employees.

#### 4.4 Descriptive Statistics

The study used descriptive statistics for analysis of the dependent and independent variables. The purpose of descriptive statistics is to enable the researcher to meaningfully describe a distribution of scores or measurements using indices or statistics. The type of statistics or indices used depends on the type of variables in the study and the scale of measurement. Measures of central tendency are used to determine the typical or expected score or measure from a sample of measurements or a group of scores in a study.

#### 4.5. Non-Audit service

The first objective of this study was to assess the effect of Non-audit Service on fraudulent financial reporting among firms listed in NSE. A five (5) point Likert scale (1=strongly disagree;

2= disagree; 3= uncertain; 4= agree; 5=strongly agree) was used to measure the views of respondents. The upper and lower limits were set based on mean analysis of Likert scale data. A mean score of 1.0-1.80 depicted strongly disagree, 1.81-2.60 indicates disagree while mean score of 2.6 -3.40 indicates moderate, 3.41-4.20 indicates agree and 4.21-5.0 indicates strongly agree (Warmbrod, 2014). In other words, a mean score of 2.61 and above indicates that the respondents agree the effect of Non-audit Service on the fraudulent financial reporting among firms listed in NSE and mean score equal to or below 1.81 signifies no relationship. The aspects under this objective were assurance services, tax advisory services and management advisory services. The results are indicated in table 4.2, 4.3 and 4.4.

#### 4.5.1: Assurance Services

The results for assurance services are as indicated in table 4.2

**Table 4.2 Assurance Services**

Statement	N	Min	Max	Mean	SD
Assurance services provided by audit firms make them vulnerable towards the management.	57	1.00	5.00	2.34	1.12
Assurance service fees makes auditors financially dependent on their clients, and hence less willing to stand up to management pressure for fear of losing their business	57	1.00	4.00	2.76	1.14
Assurance service as a consulting nature of many non-audit services inclines auditors in managerial roles, potentially threatening their objectivity about the transactions they audit	57	1.00	5.00	2.76	1.11
Firms should use a checklist and if there are any conflicts found before providing assurance service, they should withdraw from consulting	57	1.00	5.00	3.53	1.33
Assurance services provided by auditors inclines them to issuing a going concern opinion	57	1.00	5.00	3.23	1.17
Financial pressure motivates the auditors to carry out Assurance services	57	1.00	5.00	2.88	1.33

Assurance services should not be done by auditors as they lack concrete knowledge in this area

57	1.00	5.00	2.76	1.45
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In the analysis in table 4.2, the study sought to determine the descriptive statistics for assurance services, assurance services provided by audit firms make them vulnerable towards the management registered a mean of 2.34 with a standard deviation of 1.12 and the maximum value of 5 and minimum value of 1, this implies that respondents disagree that assurance services provided by audit firms make them vulnerable towards the management as depicted by a mean of 2.34 which is 1.81. Assurance service fees make auditors financially dependent on their clients, and hence less willing to stand up to management pressure for fear of losing their business recorded maximum and minimum of 5 and 1 respectively while the mean value was 2.76 and standard deviation of 1.14 which depicts that most respondents are moderate and that assurance service fees make auditors financially dependent on their clients, and hence less willing to stand up to management pressure for fear of losing their business. Firms should use a checklist and if there are any conflicts found before providing assurance service, they should withdraw from consulting registered a mean of 3.53 and the standard deviation of 1.33 which depicts that respondents agree firms should use a checklist and if there are any conflicts found before providing assurance service they should withdraw from consulting. Assurance services provided by auditors inclines them to issuing a going concern opinion registered a mean of 3.23 and the standard deviation of 1.17 which the findings implies that assurance services provided by auditors inclines them to issuing a going concern opinion. Financial pressure motivates the auditors to carry out Assurance services registered a mean value of 2.88 with the standard deviation of 1.33, the maximum and minimum value of 1 and 5 respectively, the findings depicted that financial pressure moderately motivates the auditors to carry out assurance services. Assurance services should not be done by auditors as they lack concrete knowledge in this area recorded a mean value of 2.76 while the standard deviation was 1.45 which depicts moderate opinion on whether assurance services should or should be done by auditors as they lack concrete knowledge in this area.

#### 4.5.2: Tax Advisory Services

The results for tax advisory services are as indicated in table 4.4

**Table 4.4 Tax Advisory Services**

Statement	N	Min	Max	Mean	SD
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Tax advisory services as a consulting service provided by the audit firms reduce the quality of auditor engagement	57	1.00	5.00	2.65	1.16
There should be complete diversification between audit firms providing audit services and Tax advisory as a consultancy service	57	1.00	5.00	3.26	1.28
Auditors are not experts in tax matters	57	1.00	4.00	2.61	1.06
Tax matters provide more loopholes on tax evasion that increases the rate of fraud	57	1.00	5.00	3.12	1.42
Tax advisory service fees make auditors financially dependent on their clients, and hence less willing to stand up to management pressure for fear of losing their business.	57	2.00	4.00	3.03	0.77
Tax advisory service as a consulting nature of many non-audit services puts auditors in managerial roles, potentially threatening their objectivity about the transactions they audit	57	2.00	5.00	3.15	0.88
Always use a checklist, and if there are any conflicts found before providing Tax advisory service, they will withdraw from consulting	57	1.00	5.00	3.96	1.07

In table 4.4, the study also the elements of tax advisory services, tax advisory services as a consulting service provided by the audit firms reduce the quality of auditor engagement registered a maximum and minimum value of 5 and 1 respectively, the mean and standard deviation is 2.65 and 1.16 which depicts that tax advisory services as a consulting service provided by the audit firms moderately reduce the quality of auditor engagement. There should be complete diversification between audit firms providing audit services and Tax advisory as a consultancy service registered a mean of 3.26 and the standard deviation of 1.28 which implied that there should be complete diversification between audit firms providing audit services and Tax advisory as a consultancy service. Tax matters provide more loopholes on tax evasion that increases the rate of fraud register a mean of 3.12 and the standard deviation of 1.42. The findings depict that tax matters provide moderate loopholes on tax evasion that increases the rate of fraud. Tax advisory service fees make auditors financially dependent on their clients, and hence less willing to stand up to management pressure for fear of losing their business recorded a mean of 3.03 and the standard deviation of 0.77 which implies that tax advisory service fees moderately make auditors

financially dependent on their clients, and hence less willing to stand up to management pressure for fear of losing their business. Tax advisory service as a consulting nature of many non-audit services puts auditors in managerial roles, potentially threatening their objectivity about the transactions they audit recorded a mean of 3.15 and the standard deviation of 0.88 which depicts most respondents are moderate on the opinion that tax advisory service as a consulting nature of many non-audit services puts auditors in managerial roles, potentially threatening their objectivity about the transactions they audit. Always use a checklist, and if there are any conflicts found before providing tax advisory service, they will withdraw from consulting registered a mean of 3.96 and the standard deviation of 1.07 the findings implies always use a checklist, and if there are any conflicts found before providing tax advisory service they will withdraw from consulting.

#### 4.5.3: Management Advisory Service

The results for Management Advisory Service are as indicated in table 4.6

**Table 4.4 Management Advisory Service**

Statement	N	Min	Max	Mean	SD
Auditors do not communicate fraud to management and advise due to fear of losing their job	57	1.00	5.00	2.38	1.23
Management changes its accounting policy such as changes in policies of pricing inventories or in valuating investments in order to manipulate the company's financial statements without auditors' knowledge	57	2.00	5.00	3.00	1.05
Management set aggressive financial targets and expectations for operating personnel that will affect the advice from auditors	57	1.00	5.00	2.76	0.95
Management ineffectively communicates and supports the entity's values or ethics or communicates inappropriate values or ethics	57	1.00	5.00	2.84	1.25
The level of internal controls and governance determines the level of fraud detection	57	1.00	5.00	4.07	0.89

Auditors do not pinpointing out or overlooking the mistakes done by the top management	57	1.00	5.00	2.19	1.13
Management displays a significant disregard for regulatory authorities	57	1.00	5.00	2.61	1.29

The study assessed the elements of management advisory service. Auditors do not communicate fraud to management and advise due to fear of losing their job had mean of 2.38 and standard deviation of 1.23. Auditors do not communicate fraud to management and advise due to fear of losing their job, management changes its accounting policy such as changes in policies of pricing inventories or in valuating investments in order to manipulate the company's financial statements without auditors knowledge recorded a mean of 3.00 with a standard deviation of 1.05 which implies a moderate opinion on the idea that management changes its accounting policy such as changes in policies of pricing inventories or in valuating investments in order to manipulate the company's financial statements without auditors knowledge. The level of internal controls and governance determines the level of fraud detection recorded a mean of 4.07 and the standard deviation of 0.89 which implies that level of internal controls and governance determines the level of fraud detection. Auditors do not pinpointing out or overlooking the mistakes done by the top management registered a mean of 2.19 and the standard deviation of 1.13 which implies that auditors do not pin pointing out or overlooking the mistakes done by the top management. Management display a significant disregard for regulatory authorities had a mean value of 2.61 and standard deviation of 1.29 which implies a moderate opinion on the idea that management display a significant disregard for regulatory authorities as is summarized in table 4.4

#### 4.6 Audit Quality

The second objective of this study was to determine the effect of audit quality independence on fraudulent financial reporting among firms listed in NSE. A five (5) point Likert scale (1=strongly disagree; 2= disagree; 3= uncertain; 4= agree; 5=strongly agree) was used to measure the views of respondents. The upper and lower limits were set based on mean analysis of Likert scale data. A mean score of 1.0- 1.80 depicted strongly disagree, 1.81-2.60 indicates disagree while mean score of 2.61-3.40 indicates moderate, 3.41-4.20 indicates agree and 4.21-5.0 indicates strongly agree (Warmbrod, 2014). A mean score of 2.61 and above indicates that the respondents agree the effect of auditor independence and mean score equal to or below 1.81

signifies no relationship. The aspects under this objective were auditor independence, auditor tenure and auditors opinion. The study findings are as indicated in table 4.5, 4.6 and 4.7

#### 4.6.1: Auditor independence

**Table 4.5 Auditor Independence**

Statement	N	Min	Max	Mean	SD
Auditors have a close relationship with the directors	57	1.00	5.00	2.92	0.89
Auditors are actively involved in the day-to-day activities of the organization	57	1.00	5.00	2.92	1.32
Client has full control of the auditor’s activities and audit process	57	1.00	5.00	2.34	1.35
Auditors work independently without interference from the directors and management	57	1.00	5.00	3.61	1.06
Auditors always maintain a skeptical attitude throughout the process of audit	57	2.00	5.00	3.92	0.93
Auditors are always shy of giving a bad report /qualified opinion	57	1.00	5.00	2.07	1.19
Auditors have a conflict of interest in the organization	57	1.00	5.00	2.42	1.10
Auditors hold shares in the organization	57	1.00	5.00	2.53	1.17

In table 4.5, the study sought to assess the elements of auditor independence. Auditors have a close relationship with the directors registered a minimum and maximum value of 1 and 5 respectively also it had a mean and standard deviation of 2.92 and 0.89 which depicted a moderate opinion on the idea that auditors have a close relationship with the directors. Auditors are actively involved in the day to day activities of the organization recorded a mean of 2.92 and standard deviation of 1.32, auditors work independently without interference from the directors and management recorded a mean of 3.61 and standard deviation of 1.06, Auditors are always shy of giving a bad report /qualified opinion recorded a mean of 2.07 and the standard deviation of 1.19, auditors have a conflict of interest in the organization registered a mean of 2.42 and the standard deviation of 1.10, this implies that auditors have a conflict of interest in the organization.

#### 4.6.2: Auditor Tenure

**Table 4.6 Auditor Tenure**

Statement	N	Min	Max	Mean	SD
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Long auditor Tenure (3 years) is the key determinant for an auditor to identify red flags on financial fraud	57	1.00	5.00	2.73	1.15
Incentive programs and interest rates determines the level of auditor tenure	57	1.00	5.00	3.00	1.26
Long auditor relationship/Tenure with the client reduces audit quality	57	1.00	5.00	3.00	0.93
High turnover of senior management, counsel, board members or key employees and auditors may be an attempt to prevent them from learning too much about the firm	57	1.00	5.00	2.96	1.07
Formal or informal restrictions on the auditor that limit his access to people or information or to his communication with the board members & audit committee	57	2.00	5.00	3.15	0.96
Auditor rotation should be encouraged to curb vulnerability on auditor independence	57	2.00	5.00	4.03	0.95
Longer audit tenure makes the auditor more acquainted with the company, understands its business thus more effective in audit	57	2.00	5.00	4.23	0.71

In table 4.6, the study assesses the elements of auditor tenure. Long auditor Tenure (3 years) is the key determinant for an auditor to identify red flags on financial fraud registered a minimum and maximum value of 1 and 5 respectively also it had a mean and standard deviation of 2.73 and 1.15 which depicts that long auditor tenure (3 years) is the key determinant for an auditor to identify red flags on financial fraud. Incentive programs and interest rates determine the level of auditor tenure registered a mean of 3.00 with a standard deviation of 1.26 which implies that incentive programs and interest rates determines the level of auditor tenure. High turnover of senior management, counsel, board members or key employees and auditors may be an attempt to prevent them from learning too much about the firm recorded a mean of 2.96 and the standard deviation of 1.07 which implies that high turnover of senior management, counsel, board members or key employees and auditors may be an attempt to prevent them from learning too much about the firm. Auditor rotation should be encouraged to curb vulnerability on auditor independence had a

standard deviation of 0.95 and mean score of 4.03 which implies that auditor rotation should be encouraged to curb vulnerability on auditor independence. Longer audit tenure makes the auditor more acquainted with the company, understands its business thus more effective in audit registered a mean of 4.23 and the standard deviation of 0.71 which implies that longer audit tenure makes the auditor more acquainted with the company, understands its business thus more effective in audit.

### 4.6.3: Auditors Opinion

**Table 4.7 Descriptive statistics on Auditors Opinion**

Statement	N	Min	Max	Mean	SD
The audit report should contain compliance with appropriate auditing standards	57	4.00	5.00	4.76	0.42
If the statutory auditors fail to comply with the requirements of Audit, it should be properly stated in the audit report	57	4.00	5.00	4.46	0.50
The audit report should also include the future viability of the company operation	57	2.00	5.00	3.88	0.90
Whistle blower policies should be enforced effectively to improve audit quality	57	1.00	5.00	4.15	1.00
Auditors should recite in audit reports the procedures followed without stating clearly whether an opinion is expressed	57	1.00	5.00	3.00	0.89
High investor expectations determine the auditor opinion	57	1.00	5.00	2.84	0.96
Auditors are trained to determine whether the staffs and management are telling the truth	57	1.00	5.00	3.11	1.14

In table 4.7, the audit report should contain compliance with appropriate auditing standards registered a mean of 4.76 and standard deviation of 0.42 which implies that the audit report should contain compliance with appropriate auditing standards, if the statutory auditors fail to comply with the requirements of audit it should be properly stated in the audit report recorded a mean of 4.46 and standard deviation of 0.50, the study depicts if the statutory auditors fail to comply with the requirements of audit it should be properly stated in the audit report, whistle blower policies

should be enforced effectively to improve audit quality recorded a mean of 4.15 and standard deviation of 1.00. Auditors should recite in audit reports the procedures followed without stating clearly whether or not an opinion is expressed registered a mean of 3.00 which postulates that auditors should recite in audit reports the procedures followed without stating clearly whether or not an opinion is expressed and auditors are trained to determine whether the staffs and management are telling the truth had a mean of 3.11 and standard deviation of 1.14 which means auditors are trained to determine whether the staffs and management are telling the truth.

#### **4.7. Fraudulent financial Reporting**

The study used assets misapplication and improper expense recognition to measure the level of fraudulent financial reporting. A five (5) point Likert scale (1=strongly disagree; 2=disagree; 3= uncertain; 4= agree; 5=strongly agree) was used to measure the views of respondents. The upper and lower limits were set based on mean analysis of Likert scale data. A mean score of 1.0- 1.80 depicted strongly disagree, 1.81-2.60 indicates disagree while mean score of 2.61-3.40 indicates moderate, 3.41-4.20 indicates agree and 4.21-5.0 indicates strongly agree (Warmbrod, 2014). A mean score of 2.61 and above indicates that the respondents agree and mean score equal to or below 1.

##### **4.7.1 Asset Misappropriation**

**Table 4.8 Descriptive statistics on Asset Misappropriation**

Statement	N	Min	Max	Mean	SD
Asset misappropriation is highly practiced in firms	57	1.00	5.00	3.00	1.16
There are strong internal control systems to detect and prevent misappropriation of company assets	57	1.00	5.00	3.46	1.13
Financial pressure is the root course for asset misappropriation in this company	57	1.00	5.00	2.65	1.29
The use of company telephone for private matters is misappropriation of company assets	57	1.00	5.00	3.84	0.92
Employees and managers forge cheques for personal use	57	1.00	4.00	2.57	0.85
There is always the use of false invoices in making payment for personal use to misappropriate funds	57	1.00	4.00	2.76	1.06

Skimming where funds are taken and used at the Point of receivable or refund occurs in most cases	57	1.00	4.00	2.53	1.02
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The study assessed the asset misappropriation is highly practiced in firms registered a mean of 3.00 and standard deviation of 1.16 which implies that asset misappropriation is highly practiced in firms, there are strong internal control systems to detect and prevent misappropriation of company assets recorded a mean of 3.46 and standard deviation of 1.13, the study there are strong internal control systems to detect and prevent misappropriation of company assets, the use of company telephone for private matters is misappropriation of company assets recorded a mean of 3.84 and standard deviation of 0.92. There is always the use of false invoices in making payment for personal use to misappropriate funds registered a mean of 2.76 and the standard deviation of 1.06 which postulates that there is always the use of false invoices in making payment for personal use to misappropriate funds and skimming where funds are taken and used at the Point of receivable or refund occurs in most cases recorded a mean of 2.53 and the standard deviation of 1.02 which implied that skimming where funds are taken and used at the Point of receivable or refund occurs in most cases.

#### 4.7.2: Improper Expense Recognition

**Table 4.9 Descriptive statistics on Improper Expense Recognition**

Statement	N	Min	Max	Mean	SD
The auditor should confirm all invoices and receipts to determine whether the balance shown on the company's books is in agreement with the expense records	57	2.00	5.00	3.88	0.95
Capital assets are misclassified as expenses leading to error in reporting by the auditor	57	1.00	5.00	3.15	1.08
Auditors cannot recognize expenses spent by the company for personal use	57	1.00	5.00	2.50	1.27
It's too much work for an auditor to check petty information on the receipt like the date, amount, payer, method of payment, purpose of payment, cashier's name and account distribution	57	1.00	5.00	2.42	1.33

Unusually high dependence on debt accruing high interest rates	57	2.00	5.00	3.34	1.02
Assess the risk of material misstatements due to fraud by considering fraud risk factors	57	1.00	5.00	3.92	0.93
Staffs are not trained on the correct accounting system for data entry leading to misrepresentation of expenses	57	1.00	5.00	2.92	1.26

In table 4.9 the study assessed the auditor should confirm all invoices and receipts to determine whether or not the balance shown on the company's books is in agreement with the expense records registered a mean of 3.88 and standard deviation of 0.95 which implies that the auditor should confirm all invoices and receipts to determine whether or not the balance shown on the company's books is in agreement with the expense records, Capital assets are misclassified as expenses leading to error in reporting by the auditor recorded a mean of 3.15 and standard deviation of 1.08 which depicts capital assets are misclassified as expenses leading to error in reporting by the auditor. It's too much work for an auditor to check petty information on the receipt like the date, amount, payer, method of payment, purpose of payment, cashier's name and account distribution registered a mean of 2.42 and the standard deviation of 1.33 which implies that It's too much work for an auditor to check petty information on the receipt like the date, amount, payer, method of payment, purpose of payment, cashier's name and account distribution. Assess the risk of material misstatements due to fraud by considering fraud risk factors recorded a mean of 3.92 and the standard deviation of 0.93 which depicts that assess the risk of material misstatements due to fraud by considering fraud risk factors and Staffs are not trained on the correct accounting system for data entry leading to misrepresentation of expenses recorded a mean of 2.92 and the standard deviation of 1.26 which postulates that staffs are not trained on the correct accounting system for data entry leading to misrepresentation of expenses.

#### 4.8 Correlation Analysis

Correlation is a statistical method that evaluates the strength of the relationship between two quantitative variables. In this study a correlation analysis was conducted to establish the strength of the relations between fraudulent financial reporting as the dependent variable and non-audit services and audit quality as the independent variables. In this study the Pearson's correlation was conducted which varies from -1.00 to +1. The negative values indicate a negative relationship

while the positive values relate to the positive relations among the variables. The results are as summarized in table 4.10

**Table 4.10 Correlation matrix**

Variables		Fraudulent Financial Reporting	Non Audit Services	Audit Quality
Fraudulent Financial Reporting	Pearson	1	.315*	.687**
	Correlation			
	Sig. (2-tailed)		.014	.000
	N	60	60	60
Non Audit Services	Pearson	.315*	1	.341**
	Correlation			
	Sig. (2-tailed)	.014		.008
	N	60	60	60
Audit Quality	Pearson	.687**	.341**	1
	Correlation			
	Sig. (2-tailed)	.000	.008	
	N	60	60	60

\*. Correlation is significant at the 0.05 level (2-tailed).

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

Table 4.10 indicates a weak positive correlation ( $r=0.315$ ) that is statistically insignificant ( $p=.014<.05$ ) between non-audit services and fraudulent financial reporting. The study also reveals a strong positive correlation between audit quality and fraudulent reporting ( $r=.687$ ) that is statistically significant ( $p=.000<.05$ ).

## 4.9 Diagnostic Test Results

### 4.9.1 Multi-collinearity Test

Large standard errors affect the precision and accuracy of rejection or failure to reject the null hypothesis. During estimation, the problem is not lack of multi-collinearity but rather its severity. According to Gujarati (2004), the standard statistical method for testing data for multi-collinearity is analyzing the explanatory variables; tolerance values and Variance Inflation Factor

(VIF). Therefore, in this study, to determine multi-collinearity, variance inflation factors (VIF) and tolerance Level (TL) were used. For tolerance, values of less than 0.1 suggest multi-collinearity while for values of VIF that exceed 10 are often regarded as indicating multi-collinearity. The results depict VIF is less than 10 and tolerance value above 0.1. Therefore, the results imply that there was no multi-collinearity problem among independent variables.

**Table 4.11 Multi-Collinearity Test**

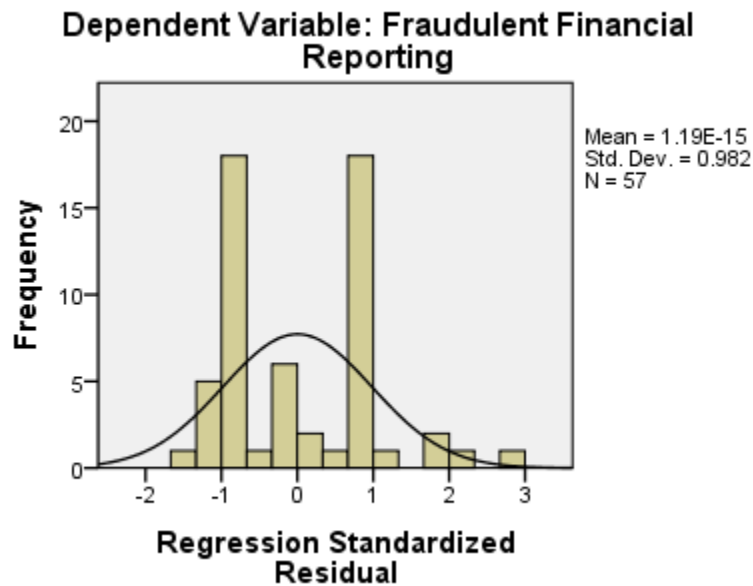
Model	Collinearity Statistics	
	Tolerance	VIF
Non Audit Services	.882	1.134
Audit Quality	.882	1.134

a. Dependent Variable: Fraudulent Financial Reporting

Table 4.11 represents the findings of the study on Multicollinearity. The results depicts VIF is less than 10 and tolerance value was above 0.1. Therefore, the results imply that there was no multi-collinearity problem among independent variables.

#### 4.9.2 Normality Test

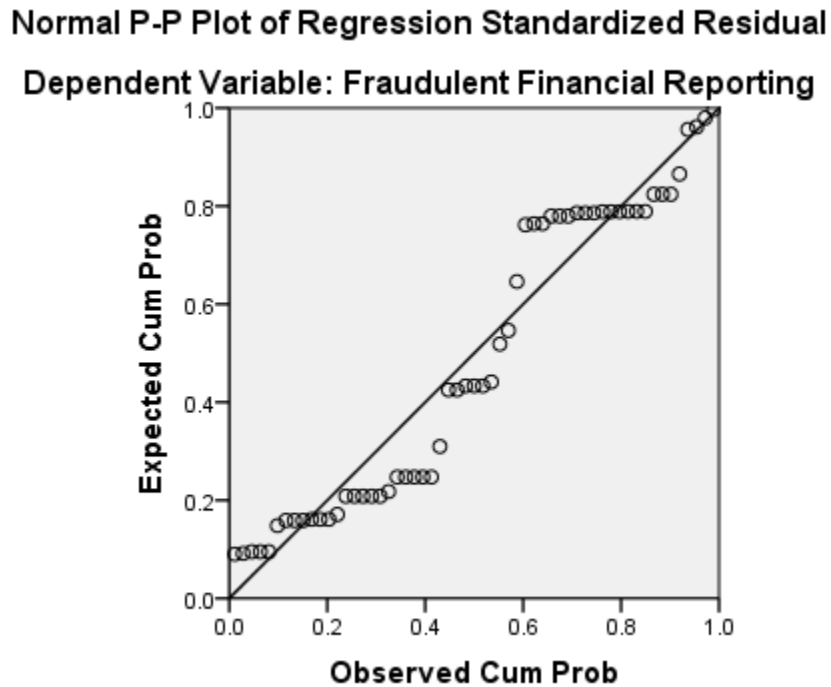
A normality test was conducted to determine the distribution of the variables. The graphical approach was used by comparing the histogram to the normal distribution curve.



#### Figure 4.4 Test for Normality

Figure 4.4 above, shows a histogram for fraudulent financial reporting which was bell shaped indicating that the data was normally distributed. The study had a mean of 3.99 and a standard deviation of 0.983 on a sample of 60 companies indicating normal distribution.

#### 4.9.3 Linearity Test



#### Figure 4.5 Linearity Test

A linearity test was conducted on the study variables to ascertain whether the independent variables (Non-Audit service and Audit Quality) in the regression have a straight-line relationship with the dependent variable (Fraudulent Financial Reporting). The findings depict the linear relationship between the variables.

#### 4.10 Inferential Statistics

Inferential statistics analysis was conducted using regression analysis to determine the relationship between the independent and the dependent variable. The coefficient of correlation (R) shows the degree of relationship between two or more variables, it measures the nature and strength of the relationship between the variables. This study used the Adjusted R-Square to show the goodness of fit of the regression model; this is because it only increases if the new term added improves the model by being relevant to the study and decreases when the added predictor adds

no relevance to the study. The coefficient of determination (R-Square) was not used as it shows some bias between the variables; it continually increases when new variables are added to the model with disregard of the relevance of those variables to the study.

#### 4.10.1 Testing of Hypotheses

To establish the relationship between the dependent and the independent variables a regression was conducted. Simple regression was conducted on objective one and two while multiple regressions was conducted on objective three which had the combined effect. The regression analysis was used to test the hypotheses at 95% confidence level (.05 level of significance). The t-Statics and the associated p- values were used to test the fitness of the study model. The decision to accept or reject the hypotheses was based on the p-values at .05 significance level. In all the tests, the decision rule was if the P value observed (calculated P) is less than the set alpha ( $\alpha$ ) that is the confidence level of 0.05, then fail to accept the null hypothesis and if the P value observed is greater than the set alpha of 0.05, do accept the null hypothesis. The testing of these hypotheses was done at a level of significance of 0.05.

##### a) Effect of Non-Audit Service on Fraudulent Financial Reporting

The first objective was to determine the effect of Non-audit Service on fraudulent financial reporting among firms listed in NSE. The hypothesis stated that Non audit services have no significant effect on fraudulent financial reporting among firms listed on the NSE. A simple regression was used to test the hypothesis. The study findings are as indicated in table 4.12, 4.13, and 4.14:

**Table 4.12 Model summary- Non-audit Service**

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.599 <sup>a</sup>	.358	.322	.59286

a. Predictors: (Constant), Management Advisory Service, Assurance Services, Tax Advisory Services

b. Dependent Variable: Fraudulent Financial Reporting

Research findings on table 4.12 shows R squared was 0.322 and it shows that the total variation 32.2% in fraudulent financial reporting can be explained by non-audit services measured by Management Advisory Service, Assurance Services and Tax Advisory Services. This means

that other factors not included in the study accounted for 67.8%. The study also found a strong relationship between the non-audit services and fraudulent financial reporting as depicted by coefficient of correlation (R) of 0.599, which is higher than 0.5 thresholds.

**Table 4.13 ANOVA- Non Audit Services**

<b>Model</b>		<b>Sum of Squares</b>	<b>df</b>	<b>Mean Square</b>	<b>F</b>	<b>Sig.</b>
1	Regression	2.728	1	2.728	5.704	.020 <sup>b</sup>
	Residual	26.304	55	.478		
	Total	29.032	56			

a. Dependent Variable: Fraudulent Financial Reporting

b. Predictors: (Constant), Non Audit Services

The ANOVA (Analysis of Variance) results on table 4.13 above shows that the F value of 5.704 was statistically significant at  $0.002 < 0.05$ , depicting a linear relationship among the variables under study. It also showed that the model had a lower than 0.05 likelihood of giving a wrong prediction. The above results shows that the independent variables (Management Advisory Service, Assurance Services and Tax Advisory Services) used was statistically significant in predicting the fraudulent financial reporting at 95% significance level.

From the findings on table 4.13, there is significant relationship between Non Audit services and Fraudulent financial reporting as ( $p=0.002<0.05$ ) a minimum of 95% confidence level. The above results thus lead to rejecting the null Hypothesis  $H_0$  that Non-Audit service has no significant effect on fraudulent financial reporting among firms listed in NSE as the P value is higher lower 0.05 threshold.

**Table 4.14 Coefficients- Non Audit Services**

<b>Model</b>	<b>Unstandardized Coefficients</b>		<b>Standardized Coefficients</b>	<b>t</b>	<b>Sig.</b>
	<b>B</b>	<b>Std. Error</b>	<b>Beta</b>		
(Constant)	1.095	.602		1.819	.075
Assurance Services	.220	.128	.212	1.718	.092
Tax Advisory Services	-.260	.187	-.178	-1.392	.170
Management Advisory Service	.776	.146	.610	5.306	.000

#### a. Dependent Variable: Fraudulent Financial Reporting

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The coefficient results from table 4.14 indicate unstandardized coefficients of  $\beta = 1.095$ ,  $p = 0.075 > .05$  constant,  $\beta = 0.220$ ,  $p = 0.092 > .05$  for Assurance Services,  $\beta = -0.260$ ,  $p = 0.170 > .05$  for Tax advisory services,  $\beta = 0.776$ ,  $p = 0.000 < .05$ . The findings indicate that the non-audit service and tax advisory services has positive and negative and insignificant effect on fraudulent financial reporting while management advisory services positively and significantly affect the fraudulent financial reporting. The derived multiple regression equation from the data in the table 4.14 was:

$$Y = 1.095 + 0.220X_1 - 0.260X_2 + 0.776X_3$$

Holding assurance services, tax advisory services and management advisory service constant the fraudulent financial reporting will be 1.095, also a unit increase in assurance services the fraudulent financial reporting will increase by 0.220 units, there is also an inverse relationship between tax advisory services and fraudulent financial reporting with a beta value of -0.260 and a unit increase in management advisory service the fraudulent financial reporting will increase by 0.776 units.

This agrees with the study by Omondi and Theuri (2019) that concluded that quality auditing is affected by other factors such tax compliance. However, Ken et al. (2019) concluded that auditors fail to adhere to accounting practices when earnings management incentives are increased therefore compromising their independence and that it is unnecessary to prohibit NAS instead, regulators and policy makers should examine the motivation for purchasing NAS particularly among audit clients with poor performance.

#### **b) Effect of Audit Quality on Fraudulent Financial Reporting**

The second objective of the study is to assess the effect of audit quality on fraudulent financial reporting among firms listed in NSE. The hypothesis for the objective was that audit quality has no significant effect on fraudulent financial reporting among listed firms in NSE. A regression model was used to test the hypothesis and the study findings are indicated in table 4.15, 4.16 and 4.17.

**Table 4.15 Model Summary-Audit Quality**

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.776 <sup>a</sup>	.602	.579	.46695

a. Predictors: (Constant), Auditor Opinion, Auditor Independence, Auditor Tenure

b. Dependent Variable: Fraudulent Financial Reporting

Research findings on table 4.15 shows R squared was 0.579 depicting that a total variation of 57.9% in fraudulent financial reporting can be explained by variation in Auditor Opinion, Auditor Independence, and Auditor Tenure. This means that other factors not included in the study accounted for 42.1%. The study also found a strong relationship between the Auditor Opinion, Auditor Independence, Auditor Tenure and fraudulent financial reporting as depicted by coefficient of correlation (R) of 0.776, which is higher than 0.5 threshold.

**Table 4.16 ANOVA-Audit Quality**

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	17.476	3	5.825	26.717	.000 <sup>b</sup>
	Residual	11.556	53	.218		
	Total	29.032	56			

a. Dependent Variable: Fraudulent Financial Reporting

b. Predictors: (Constant), Auditor Opinion, Auditor Independence, Auditor Tenure

The ANOVA (Analysis of Variance) results on table 4.16 above shows that the F value of 26.717 was statistically significant at  $0.000 < 0.05$ . This depicts a linear relationship among the variables under study and that the model had a lower than 0.05 likelihood of giving a wrong prediction. The above results also show that the independent variable (Auditor Opinion, Auditor Independence, and Auditor Tenure) used was statistically significant in predicting the fraudulent financial reporting at 95% significance level. The results indicate a positive and statistically significant effect in fraudulent reporting among listed firms in NSE ( $p = .000 < .05$ ).

From the findings on table 4.16, Audit quality factors have a significant effect of  $p = .000 < .05$  on Fraudulent financial reporting, a minimum of 95% significance level. Based on these findings, the study therefore rejects the null hypothesis (Ho2) which states that quality audit has no significant effect on fraudulent financial reporting on firms listed in the NSE

**Table 4.17 Coefficients- Audit Quality**

Model	Unstandardized		Standardized	t	Sig.
	Coefficients				
	B	Std. Error	Beta		
(Constant)	-1.433	.629		-2.278	.027
Auditor Independence	.463	.120	.364	3.847	.000
Auditor Tenure	.534	.142	.417	3.774	.000
Auditor Opinion	.397	.220	.209	1.803	.077

a. Dependent Variable: Fraudulent Financial Reporting

The coefficient results from table 4.17 indicate unstandardized coefficients of  $\beta = -1.433$ ,  $p = 0.000 < .05$  constant,  $\beta = 0.463$ ,  $p = 0.000 < .05$  for Auditor Independence,  $\beta = 0.534$ ,  $p = 0.000 < .05$  for Auditor Tenure,  $\beta = 0.397$ ,  $p = .077 > .05$ . The regression equation derived from the data in table 4.17 was:

$$Y = -1.433 + 0.463X_1 + 0.534X_2 + 0.397X_3$$

Holding Auditor Independence, Auditor Tenure and Auditor Opinion constant the fraudulent financial reporting would be -1.433 units and a unit increase in Auditor Independence will lead to an increase in fraudulent financial reporting by 0.463 units. Also, a unit increase in auditor tenure, fraudulent reporting will increase by 0.534. This implies a positive relationship between audit quality and fraudulent financial reporting. The findings are summarized in table 4.17.

The study concludes that audit quality has significant effect on fraudulent reporting among firms listed in NSE. The findings are similar to the study findings by Kwabena (2017) that showed that, internal and external auditors have a key role and duty of detecting financial fraud in an organization. This is determined by the auditor's proficiency. Jonathan (2014) concludes that the management put in place quality policies in relation to auditing as there exists a positive relationship between cooperate governance and quality auditing.

### c) Effect of combined Non-audit Serves, Audit Quality and Fraudulent Financial Reporting

The third objective was to determine the combined effect of non-audit services and audit quality in fraudulent financial reporting among firms listed on the NSE. The hypothesis stated that combined non-audit services and audit quality have no significant effect on fraudulent reporting

among firms listed in the NSE. A multiple regression was conducted to establish the overall effect between the non-audit services and audit quality and the fraudulent reporting. The study findings are indicated in tables 4.18, 4.19 and 4.20.

**Table 4.18 Model Summary**

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.691 <sup>a</sup>	.477	.458	.53005

a. Predictors: (Constant), Audit Quality, Non Audit Services

b. Dependent Variable: Fraudulent Financial Reporting

Model summary in table 4.18 shows the output for model fitness and value of R squared was 0.458. This shows that the variables (Audit Quality, Non Audit Services) tested had a variation 45.8% on the fraudulent financial reporting at 95% confidence interval. The above independent variables that were studied, explain 45.8% of the relationship between Non-Audit Services, Audit Quality and Fraudulent Financial Reporting among firms listed in NSE as represented by the adjusted R2. This therefore means that other factors not accounted in this study contribute 54.2%. R is the correlation coefficient which shows the relationship between the study variables. The finding shows that there was a strong positive relationship between the study variables as shown by R which is the correlation coefficient of 0.691.

**Table 4.19 ANOVA**

Model	Sum of Squares	df	Mean Square	F	Sig.
Regression	13.861	2	6.930	24.667	.000 <sup>b</sup>
Residual	15.171	54	.281		
Total	29.032	56			

a. Dependent Variable: Fraudulent Financial Reporting

b. Predictors: (Constant), Audit Quality , Non Audit Services

The ANOVA (Analysis of Variance) results on table 4.19 above shows that the F value of 24.667 was statistically significant at p=0.000, which was lower than 0.05. The above results shows that the independent variables (Audit Quality, Non Audit Services) used was statistically significant in predicting the fraudulent financial reporting of firms listed in NSE at 95% significance level.

As presented in table 4.19, Non-Audit service and Audit quality have positive and statistically significant effect on fraudulent financial reporting among firms listed in NSE (p=0.000) a minimum of 95% confidence level. From the above results, the study rejects the null Hypothesis H<sub>03</sub>; Non-Audit service and Audit quality have no joint significant influence on fraudulent financial reporting among firms listed in NSE.

**Table 4.20 Coefficients**

Model	Unstandardized		Standardized	t	Sig.
	Coefficients		Coefficients		
	B	Std. Error	Beta		
(Constant)	.096	.500		.192	.849
Non Audit Services	.131	.146	.091	.895	.374
Audit Quality	.921	.143	.656	6.456	.000

a. Dependent Variable: Fraudulent Financial Reporting

The study composed a composite index for the variables of Non Audit service and Audit Quality using excel before exporting the variables to the SPSS. The regression result presented in table 4.20 indicates Non Audit Services and Audit quality factors had positive coefficients: constant ( $\beta = 0.096$ ,  $p = .000 < .05$ ), coefficient for non-audit services ( $\beta = .131$ ,  $p = .374 > .05$ ) and audit quality coefficient of  $\beta = 0.921$ ,  $p = .000 < .05$ . The coefficients were used to answer the following regression model which relates to the independent and dependent variables. As per the SPSS generated, the multiple regressions is summarized as indicated

$$Y = 0.096 + 0.131X_1 + 0.921X_2$$

The regression equation above has established that holding independent variables (Non Audit Services and Audit Quality) to be constant fraudulent financial reporting will be 0.096. Audit quality had positive coefficients of 0.131; non audit services had a positive beta coefficient of 0.921. This implies that taking all other variables constant, a unit increase in non-audit services will lead to 0.131 increases in fraudulent financial reporting while a unit increase in audit quality services will lead to 0.921 increases in fraudulent financial reporting on firms listed on the NSE.

The study concludes that the combined non-audit services and quality audit have a significant effect on fraudulent financial reporting among firms listed in NSE. The study agrees with a study by Kalui and Mbakaya (2014) that confirmed that corporate scandals require high quality audit and considerable attention to different factors that may have effect on audit quality.

Tumwabaza et al. (2018) suggests that audit quality is determined by factors relating to the quality of the audit team as quality influences quality reporting and minimizes fraud occurrence.

## CHAPTER FIVE

### SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

#### 5.1 Summary of the Findings

The study sought to determine the relationship between Non-Audit Services, Audit Quality and Fraudulent Financial Reporting among firms listed in NSE. The study used primary data. The study findings are summarized as the research objectives.

##### **5.1.1 To Determine the Effect of Non-Audit Service on Fraudulent Financial Reporting among Firms Listed In NSE.**

From the above findings, Non audit service has positive and insignificant effect on fraudulent financial reporting (Beta value=0.131,  $p=0.374$ ) a minimum of 95% confidence level. The above results thus lead to failing to reject the null Hypothesis  $H_01$  that Non-Audit service has no significant effect on fraudulent financial reporting among firms listed in NSE. The study findings also depict that non audit services positively affect the fraudulent financial reporting among firms listed in NSE.

##### **5.1.2 To Assess the Effect of Audit quality on fraudulent financial reporting among firms listed in NSE.**

From the findings on table 4.16, Audit quality factors have a significant effect of  $p=.000<.05$  on Fraudulent financial reporting, a minimum of 95% significance level. Based on these findings, the study therefore rejects the null hypothesis ( $H_02$ ) which states that quality audit has no significant effect on fraudulent financial reporting on firms listed in the NSE

##### **5.1.3 To assess the joint effect of Non audit service and audit quality on fraudulent financial reporting among firms listed in NSE.**

The third objective sort to examine the joint effect of Non audit service and audit quality on fraudulent financial reporting among firms listed on NSE. The results of the study showed that combined non-audit services and audit quality factors have a significant positive relationship with fraudulent financial reporting among firms in the NSE. This was specified by the results that showed the F value of 26.273 which was statistically significant at  $p=0.000$ . This was lower than 0.05, ( $p=.000<.05$ ). This study revealed that combined non-audit services and audit quality positively affect fraudulent financial reporting.

## **5.2 Conclusions**

The study sought to determine the effect of Non-audit Service on fraudulent financial reporting among firms listed in NSE. From the above findings non audit service has positive and insignificant effect on fraudulent financial reporting. The above results thus lead to failing to reject the null Hypothesis  $H_01$  that Non-Audit service has no significant effect on fraudulent financial reporting among firms listed in NSE. The study findings also depict that non audit services positively affect the fraudulent financial reporting among firms listed in NSE.

Secondly the study assessed the effect Audit quality on fraudulent financial reporting among firms listed in NSE. From the above findings, the study found audit quality positively but significantly affects the fraudulent financial reporting among firms listed in NSE. The above results thus lead to rejecting the null Hypothesis that Audit Quality has no significant effect on fraudulent financial reporting among firms listed in NSE.

The study also determined the joint effect of Non audit service and audit quality on fraudulent financial reporting among firms listed in NSE. Non-Audit service and Audit quality have positive and statistically significant effect on fraudulent financial reporting among firms listed in NSE. The above results thus lead to rejecting the null Hypothesis  $H_03$ ; Non-Audit service and Audit quality have no joint significant influence on fraudulent financial reporting among firms listed in NSE.

## **5.3 Recommendations for Policy and Practice**

The study concluded that non-audit services have a significant effect on fraudulent financial reporting on firms listed on the NSE. This is therefore a significant tool in the determination of fraudulent financial reporting among firm listed on the NSE. The study recommended that auditors should not provide non-audit services to firms as they do not have the experience in that area. To provide independent opinion, auditors should not be financially dependent on their clients.

The study also concluded that audit quality has a significant effect on fraudulent financial reporting among listed firms on the NSE. The study recommends the rotation of auditors in order to curb vulnerability in the auditor's performance. Overstaying in provision of services to one client compromises the quality of reports provided.

Lastly the study concluded that combined non-audit services and audit quality have a significant effect in fraudulent financial reporting among listed firms on the NSE. To ensure the

watchdog role of auditors, they should avoid the provision of other non-audit services to the firm they audit. There should be no restriction of information to the auditors whether formal or informal in relation to the audit at hand. Therefore, both the non-audit services and audit quality combined influence the fraudulent financial reporting.

#### **5.4 Contributions to the Body of Knowledge**

The study contributes to the body of knowledge by filling the gap in the previous studies. The study was conducted to determine the effect of non-audit service, audit quality and financial reporting among firms listed on the NSE. The empirical literature reviewed indicated studies were carried out on how to determine how individual independent variables affect fraudulent financial reporting in organizations. This study focused on the combined effect of the non-audit services and audit quality and their effect in fraudulent financial reporting. The study will be used to fill this gap.

The study provides a model that will be used by firms listed on the NSE in fraudulent reporting. The reviewed literature revealed that such a study had not been carried out on listed firms among the NSE. The model is guided by the framework which indicates that when combined non-audit services and quality reporting is a significant tool in fraudulent financial reporting.

#### **5.5 Suggestions for Further Research**

The main objective of the study was to determine the effect of non-audit services, audit quality and fraudulent financial reporting among listed firms on the NSE. The current study concentrated among listed firms on the NSE. The study recommends such a study be carried out on non-listed firms on the NSE.

From the study 45.8% of fraudulent financial reporting can be explained by non-audit services and audit quality 54.2% is explained by other factors. The study recommends that further research be conducted on other factors that contribute to the fraudulent financial reporting. These factors to be include in the variables under this study and assist in uncovering fraudulent financial reporting.

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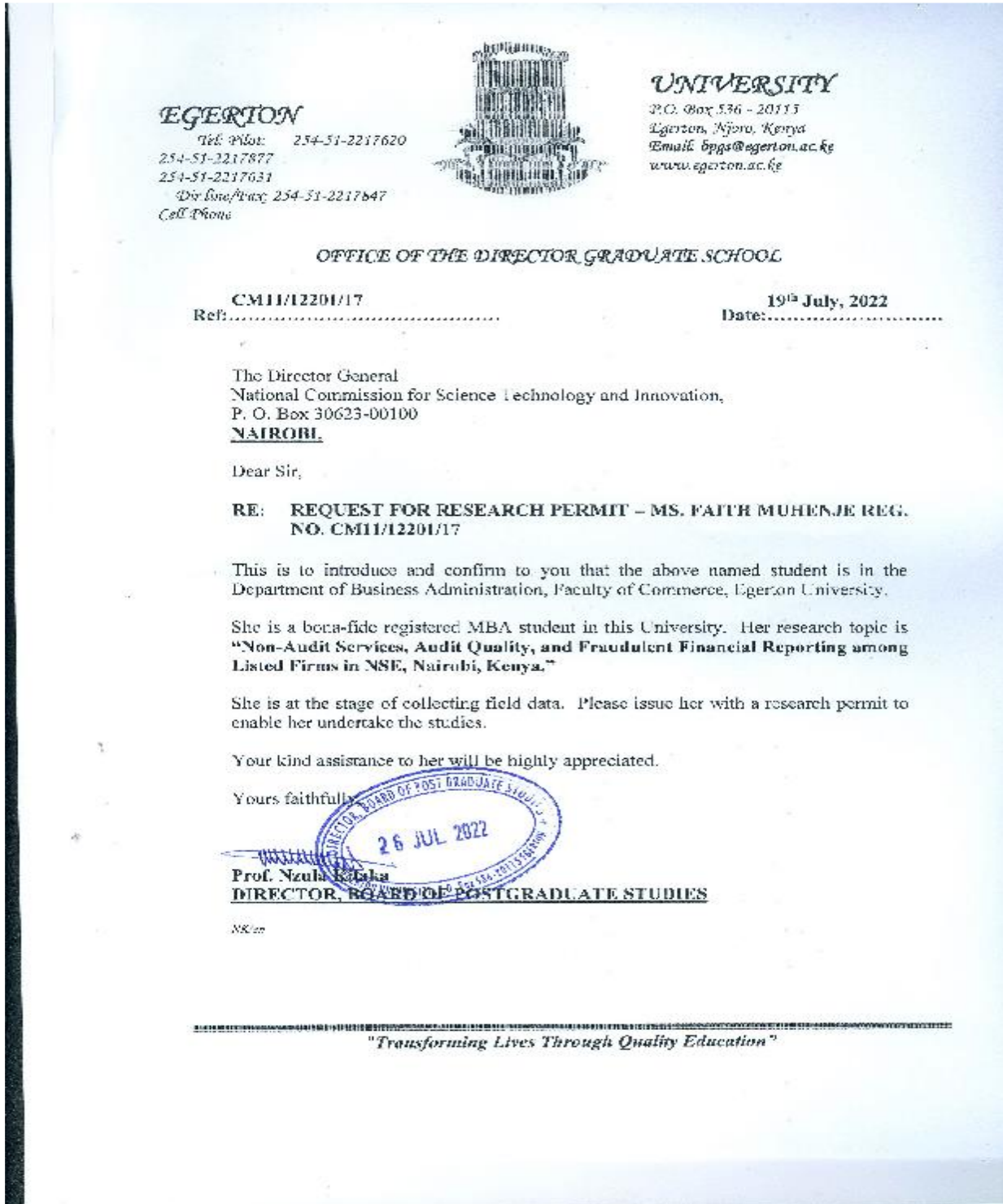
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APPENDICES

Appendix a: Introduction Letter to NACOSTI



## Appendix b: Introduction Letter to NACOSTI

 <b>REPUBLIC OF KENYA</b>	 <b>NATIONAL COMMISSION FOR SCIENCE, TECHNOLOGY &amp; INNOVATION</b>
Ref No: <b>129342</b>	Date of Issue: <b>28/July/2022</b>
<b>RESEARCH LICENSE</b>	
	
<b>This is to Certify that Miss. FAITH N/A MUHENJE of Egerton University, has been licensed to conduct research in Nairobi on the topic: NON-AUDIT SERVICES, AUDIT QUALITY, AND FRAUDULENT FINANCIAL REPORTING AMONG LISTED FIRMS IN NSE, NAIROBI, KENYA for the period ending : 28/July/2023.</b>	
License No: <b>NACOSTI/P/22/19416</b>	
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**Appendix c: Research Questionnaire**

A study to seek the relationship between Non-Audit Services, Audit Quality and Fraudulent Financial Reporting among Listed firms in NSE

You are kindly requested to answer the questions below honestly and note that the information provided will purely be used for academic research only thus it will be treated with at most confidentiality. I greatly value you and appreciate your cooperation.

Tick or fill in the blanks where applicable through all the questions.

**SECTION A: Respondents Demographic Information (Please tick where applicable)**

1. Gender

Male ( )

Female ( )

2. Number of years of experience in audit field

1-5 Years ( )

6-10 Years ( )

10-15 Years ( )

Above 15 Years ( )

3. Education level

CPA K ( )

Other Professional qualifications

Postgraduate ( ) Undergraduate ( )

Diploma ( ) Certificate ( )

Any other.....

**SECTION B: ASSURANCE SERVICES**

Please tick the degree to which you agree with the statement on Assurance Services.

**Where 1= Strongly Disagree, 2= Disagree, 3=Neutral, 4=Agree 5=strongly agree**

	STATEMENT	1	2	3	4	5
1	Assurance services provided by audit firms makes them vulnerable towards the management.					

2	Assurance service fees makes auditors financially dependent on their clients, and hence less willing to stand up to management pressure for fear of losing their business.					
3	Assurance service as a consulting nature of many non-audit services inclines auditors in managerial roles, potentially threatening their objectivity about the transactions they audit					
4	Firms should use a checklist and if there are any conflicts found before providing assurance service they should withdraw from consulting					
5	Assurance services provided by auditors inclines them to issuing a going concern opinion					
6	Financial pressure motivates the auditors to carry out Assurance services					
7	Assurance services should not be done by auditors as they lack concrete knowledge in this area.					

**SECTION C: TAX ADVISORY SERVICES**

Please tick the degree to which you agree with the statement on Tax Advisory Services.

Where 1= Strongly Disagree, 2= Disagree, 3=Neutral, 4=Agree 5=strongly agree

	STATEMENT	1	2	3	4	5
1	Tax advisory services as a consulting service provided by the audit firms reduce the quality of auditor engagement.					
2	There should be complete diversification between audit firms providing audit services and Tax advisory as a consultancy service					
3	Auditors are not experts in tax matters					
4	Tax matters provide more loopholes on tax evasion that increases the rate of fraud					
5	Tax advisory service fees make auditors financially dependent on their clients, and hence less willing to stand up to management pressure for fear of losing their business.					

6	Tax advisory service as a consulting nature of many non-audit services puts auditors in managerial roles, potentially threatening their objectivity about the transactions they audit					
7	Always use a checklist, and if there are any conflicts found before providing Tax advisory service they will withdraw from consulting					

**SECTION D: MANAGEMENT ADVISORY SERVICE**

Please tick the degree to which you agree with the statement on Management Advisory Service.

Where 1= Strongly Disagree, 2= Disagree, 3=Neutral, 4=Agree 5=strongly agree

	STATEMENT	1	2	3	4	5
1	Auditors do not communicate fraud to management and advise due to fear of losing their job					
2	Management changes its accounting policy such as changes in policies of pricing inventories or in valuating investments in order to manipulate the company’s financial statements without auditors knowledge					
3	Management set aggressive financial targets and expectations for operating personnel that will affect the advice from auditors.					
4	Management ineffectively communicates and supports the entity’s values or ethics or communicates inappropriate values or ethics.					
5	The level of internal controls and governance determines the level of fraud detection.					
6	Auditors do not pin pointing out or overlooking the mistakes done by the top management					
7	Management display a significant disregard for regulatory authorities.					

**SECTION E: AUDITOR INDEPENDENCE**

Please tick the degree to which you agree with the statement on Auditor Independence.

Where 1= Strongly Disagree, 2= Disagree, 3=Neutral, 4=Agree 5=strongly agree

	STATEMENT	1	2	3	4	5
1	Auditors have a close relationship with the directors					
2	Auditors are actively involved in the day to day activities of the organization.					
3	Client has full control of the auditors activities and audit process					
4	Auditors work independently without interference from the directors and management					
5	Auditors always maintain a skeptical attitude throughout the process of audit					
6	Auditors are always shy of giving a bad report /qualified opinion					
7	Auditors have a conflict of interest in the organization					
8	Auditors hold shares in the organization					

#### SECTION F: AUDITOR TENURE

Please tick the degree to which you agree with the statement on Auditor Tenure.

Where 1= Strongly Disagree, 2= Disagree, 3=Neutral, 4=Agree 5=strongly agree

	STATEMENT	1	2	3	4	5
1	Long auditor Tenure (3 years) is the key determinant for an auditor to identify red flags on financial fraud.					
2	Incentive programs and interest rates determines the level of auditor tenure					
3	Long auditor relationship/Tenure with the client reduces audit quality					
4	High turnover of senior management, counsel, board members or key employees and auditors may be an attempt to prevent them from learning too much about the firm.					
5	Formal or informal restrictions on the auditor that limit his access to people or information or to his communication with the board members & audit committee					
6	Auditor rotation should be encouraged to curb vulnerability on auditor independence					

7	Longer audit tenure makes the auditor more acquainted with the company , understands its business thus more effective in audit					
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**SECTION G: AUDITOR OPINION**

Please tick the degree to which you agree with the statement on Auditor Opinion.

Where 1= Strongly Disagree, 2= Disagree, 3=Neutral, 4=Agree 5=strongly agree

	STATEMENT	1	2	3	4	5
1	The audit report should contain compliance with appropriate auditing standards					
2	If the statutory auditors fail to comply with the requirements of Audit it should be properly stated in the audit report					
3	The audit report should also include the future viability of the company operation					
4	Whistle blower policies should be enforced effectively to improve audit quality					
5	Auditors should recite in audit reports the procedures followed without stating clearly whether or not an opinion is expressed					
6	High investor expectations determines the auditor opinion					
7	Auditors are trained to determine whether the staffs and management are telling the truth					

**SECTION H: ASSET MISAPPROPRIATION**

Please tick the degree to which you agree with the statement on Asset Misappropriation.

Where 1= Strongly Disagree, 2= Disagree, 3=Neutral, 4=Agree 5=strongly agree

	STATEMENT	1	2	3	4	5
1	Asset misappropriation is highly practiced in firms					
2	There are strong internal control systems to detect and prevent misappropriation of company assets					
3	Financial pressure is the root course for asset misappropriation in this company					

4	The use of company telephone for private matters is misappropriation of company assets					
5	Employees and managers forge cheques for personal use					
6	There is always the use of false invoices in making payment for personal use to misappropriate funds					
7	Skimming where funds are taken and used at the Point of receivable or refund occurs in most cases					

**SECTION I: IMPROPER EXPENSE RECOGNITION**

Please tick the degree to which you agree with the statement on Improper Expense Recognition.

**Where 1= Strongly Disagree, 2= Disagree, 3=Neutral, 4=Agree 5=strongly agree**

	STATEMENT	1	2	3	4	5
1	The auditor should confirm all invoices and receipts to determine whether or not the balance shown on the company's books is in agreement with the expense records					
2	Capital assets are misclassified as expenses leading to error in reporting by the auditor					
3	Auditors cannot recognize expenses spent by the company for personal use					
4	It's too much work for an auditor to check petty information on the receipt like the date, amount, payer, method of payment, purpose of payment, cashier's name and account distribution					
5	Unusually high dependence on debt accruing high interest rates					
6	Assess the risk of material misstatements due to fraud by considering fraud risk factors					
7	Staffs are not trained on the correct accounting system for data entry leading to misrepresentation of expenses					

**Appendix d: List of NSE Firms**

LIST OF COMPANIES LISTED IN NSE-63

NO.		NO.	
<b>AGRICULTURAL</b>			
<b>1</b>	Eaagads ltd	<b>1</b>	
<b>2</b>	Kapchorwa Tea Co.ltd	<b>2</b>	
<b>3</b>	Kakuzi	<b>3</b>	
<b>4</b>	Limuru Tea Co.Ltd	<b>4</b>	
<b>5</b>	Rea Vipingingo plantation ltd	<b>5</b>	
<b>6</b>	Sasini Ltd	<b>6</b>	
<b>7</b>	Williamson Tea Kenya ltd	<b>7</b>	
<b>AUTOMOBILES AND ACCESSORIES</b>			
<b>8</b>	Car and General (k) ltd	<b>1</b>	
<b>BANKING</b>			
<b>9</b>	Absa Bank Kenya	<b>1</b>	
<b>10</b>	Stanbic Bank	<b>2</b>	
<b>11</b>	I &M Holdings ltd	<b>3</b>	
<b>12</b>	Diamond Trust Bank Kenya ltd	<b>4</b>	
<b>13</b>	HF Group ltd	<b>5</b>	
<b>14</b>	KCB Group ltd	<b>6</b>	
<b>15</b>	NationalBank of Kenya ltd	<b>7</b>	
<b>16</b>	NCBA Group	<b>8</b>	
<b>17</b>	Standard Chartered Bank ltd	<b>9</b>	
<b>18</b>	Equity group Holdings	<b>10</b>	
<b>19</b>	The Co-operative Bank of Kenya ltd	<b>11</b>	
<b>20</b>	BK Group	<b>12</b>	

<b>COMMERCIAL AND SERVICES</b>			
<b>21</b>	Express ltd	<b>1</b>	
<b>22</b>	Sameer Africa ltd	<b>2</b>	
<b>23</b>	Kenya Airways ltd	<b>3</b>	
<b>24</b>	Nation media group	<b>4</b>	
<b>25</b>	Standard group ltd	<b>5</b>	
<b>26</b>	TPS Eastern Africa(Serena) ltd	<b>6</b>	
<b>27</b>	Scan group ltd	<b>7</b>	
<b>28</b>	Uchumi Supermarket ltd	<b>8</b>	
<b>29</b>	Longorn publishers ltd	<b>9</b>	
<b>30</b>	Deacons(East Africa)	<b>10</b>	
<b>31</b>	Nairobi Business ventures ltd	<b>11</b>	
<b>CONSTRUCTION AND SERVICE</b>			
<b>32</b>	Athi River mining	<b>1</b>	
<b>33</b>	Bamburi cement ltd	<b>2</b>	
<b>34</b>	Crown paint Kenya ltd	<b>3</b>	
<b>35</b>	E.A cables ltd	<b>4</b>	
<b>36</b>	E.A Portland cement ltd	<b>5</b>	
<b>ENERGY AND PETROLEUM</b>			
<b>37</b>	Total	<b>1</b>	
<b>38</b>	Kengen	<b>2</b>	
<b>39</b>	Kenya Power & Lighting co.ltd	<b>3</b>	
<b>40</b>	Umeme ltd	<b>4</b>	
<b>INSURANCE</b>			
<b>41</b>	Jubilee Holdings	<b>1</b>	
<b>42</b>	Sanlam Kenya	<b>2</b>	
<b>43</b>	Kenya Reinsurance Corporations ltd	<b>3</b>	

<b>44</b>	Liberty Kenya Holdings ltd	<b>4</b>	
<b>45</b>	Britam Holdings ltd	<b>5</b>	
<b>46</b>	CIC Insurance group ltd	<b>6</b>	
<b>INVESTMENT</b>			
<b>47</b>	Olympia Capital Holdings ltd	<b>1</b>	
<b>48</b>	Centum Investment co.ltd	<b>2</b>	
<b>49</b>	Trans-Century ltd	<b>3</b>	
<b>50</b>	Home Africa ltd	<b>4</b>	
<b>51</b>	Kurwita Ventures	<b>5</b>	
<b>INVESTMENT SERVICES</b>			
<b>52</b>	Nairobi Securities Exchange	<b>1</b>	
<b>MANUFACTURING AND ALLIED</b>			
<b>53</b>	B.OC Kenya ltd	<b>1</b>	
<b>54</b>	British American Tobacco Kenya ltd	<b>2</b>	
<b>55</b>	.East African Breweries ltd	<b>3</b>	
<b>56</b>	Mumias Sugar	<b>4</b>	
<b>57</b>	Unga group ltd	<b>5</b>	
<b>58</b>	Ever ready East Africa ltd	<b>6</b>	
<b>59</b>	Kenya orchards ltd	<b>7</b>	
<b>60</b>	Flame Tree group Holdings ltd	<b>8</b>	
<b>TELECOMMUNICATION AND TECHNOLOGY</b>			
<b>61</b>	Safaricom	<b>1</b>	
<b>REAL ESTATE INVESTMENT TRUST</b>			
<b>62</b>	Stanlib Fahari-Reit	<b>1</b>	

EXCHANGE TRADED FUND			
63	New Gold issuer (RP) ltd	1	
63		63	

Source: NSE Website 2023

## Appendix e: A copy of publication

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### **Non-Audit Services, Audit Quality, And Fraudulent Financial Reporting Among Listed Firms In Nse, Nairobi, Kenya**

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#### **Abstract**

The NSE firms contribute highly to national economic growth thus if fraudulent reporting is left without being detected, it will highly affect the public just like the Anglo leasing effects that are still being experienced in Kenya. This research sought to examine the relationship between non-audit services, audit quality and fraudulent financial reporting among listed firms in NSE. The specific objective was to establish the effect of Non audit services on fraudulent financial reporting, the effect of Audit quality on Fraudulent Financial reporting and lastly to establish the joint effect non-audit services, Audit Quality and Fraudulent Financial reporting among firms listed in NSE. The study used a descriptive research design with a study population of 63 as listed by NSE 2023 and a Census survey was adopted. The researcher targeted the appointed internal auditors from each firm as the respondents. The data was of primary nature where 57 closed ended questionnaires were dropped and picked for analysis while the 6 questionnaires were used in pilot study. The data collected was run via SPSS software. Quantitative method of analyzing data that is descriptive statistical method where the statistical tools such as mean, mode and standard deviation was adopted. Inferential statistic such as simple and multiple regression models was used to predict the relationships among the variables. Findings on the first objective showed that non audit service has positive and insignificant effect on fraudulent financial reporting. On the second objective, findings showed that audit quality positively but significantly affect the fraudulent financial reporting among firms listed in NSE. Finally on the joint effect non-audit service and Audit quality have positive and statistically significant effect on fraudulent financial reporting among firms listed in at a minimum of 95% confidence level. The study recommends that further research be conducted on other factors not covered under this study; that contribute to fraudulent reporting to assist in uncovering fraudulent financial reporting. The study is significant to investors, portfolio managers and other market players to make the best decisions regarding investments. The study is also significant to those charged with governance to ensure there is production of quality financial statements.

**Key Words:** Non-Audit Services, Audit Quality, Fraudulent Financial Reporting.

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