

# Influence of External Audit Report Quality on Financial Stewardship in Water and Sewerage Firms: Evidence from Kenya's Central Rift Region

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**Abstract:** *This research examines how the quality of external audit reports influences financial stewardship within water and sewerage service providers in Kenya's Central Rift Region. utilizing a descriptive design and collecting data from 63 senior managers across six public utility firms, the study applies correlation and regression analysis to establish that high-quality audit reports significantly enhance transparency and Accountability. Findings reveal a strong positive relationship( $r=0.841$ ) between audit quality and financial stewardship. The results underscore the need for professional audit standards, timely reporting and implementation of audit recommendations to strengthen*

**Keywords:** Audit Report Quality, Financial Stewardship, water utilities, Public sector governance, Kenya

## 1. Introduction

Financial stewardship, defined as the responsible planning and management of financial resources, is increasingly seen as a cornerstone of sustainable governance in public utility organizations worldwide. Globally, external audits are recognized as a key mechanism for promoting transparency, accountability, and prudent financial practices (OECD, 2021). According to the International Federation of Accountants (IFAC, 2020), the quality of external audit reports reflected in independence, clarity, and accuracy plays a critical role in ensuring the credibility of financial statements and guiding effective financial oversight. For instance, in countries like New Zealand and Canada, enhanced audit quality frameworks have significantly improved the governance of public service utilities by enabling early detection of financial irregularities (ACCA, 2022). As regulatory expectations increase, there is global consensus that high-quality audits are essential in preventing mismanagement and in strengthening public trust in utility management (World Bank, 2023).

In Africa, public sector entities, including water and sewerage utilities, often face challenges related to weak governance, poor audit implementation, and limited responsiveness to audit recommendations (Afrobarometer, 2021). According to the African Organization of English-speaking Supreme Audit Institutions (AFROSAI-E, 2020), many countries struggle with audit quality due to limited resources, political interference, and lack of professional independence. However, nations like South Africa and Rwanda have made significant strides in improving external audit frameworks, resulting in better public financial management outcomes (PwC Africa, 2022). High-quality audit reports have been shown to positively influence financial discipline and

operational efficiency among water boards and municipal utilities (Makanya & Banda, 2021). Nevertheless, audit findings are often underutilized in decision-making, leading to recurrent financial mismanagement in key infrastructure sectors.

In Kenya, the Auditor-General's reports have consistently highlighted concerns regarding the financial performance and accountability of water service providers (Office of the Auditor-General [OAG], 2022). Water and sewerage firms in particular have faced issues ranging from poor utilization of funds to lack of compliance with audit recommendations (WASREB, 2023). The Water Services Regulatory Board (WASREB) has noted that while external audits are routinely conducted, the quality and timely dissemination of these reports remain inconsistent, thereby limiting their influence on financial stewardship (WASREB, 2023). Moreover, the Public Finance Management (PFM) Act (2012, revised 2022) emphasizes the role of external audit in enhancing transparency in state corporations, including water utilities. However, a study by Njoroge and Odhiambo (2021) revealed that many audit reports in the sector lack follow-through mechanisms, leading to repeated financial mismanagement. Strengthening audit report quality especially in terms of clarity, objectivity, and action ability could play a transformative role in the financial sustainability of these firms.

### 1.1 Statement of the Problem

Despite the existence of regulatory frameworks mandating regular external audits in Kenya's public sector, persistent concerns remain regarding the quality and utility of audit reports, particularly within water and sewerage firms. Reports from the Office of the Auditor-General (OAG, 2022)

consistently highlight recurring issues such as irregular expenditures, weak internal controls, and non-compliance with financial procedures across water utilities. These challenges point not only to operational weaknesses but also to concerns over the effectiveness and quality of audit reports in promoting financial stewardship. In the Central Rift Region, several water and sewerage companies have come under scrutiny for financial mismanagement, revenue leakages, and poor responsiveness to audit findings (WASREB, 2023). While external audits are conducted routinely, questions arise about their credibility, clarity, independence, and the degree to which they influence financial decision-making and governance. This raises a critical issue: are the external audit reports merely procedural, or do they meaningfully shape financial stewardship in these utility firms? Furthermore, existing literature has largely focused on audit frequency or audit compliance, with limited empirical focus on the quality of audit reports and their direct influence on financial accountability, transparency, and prudent resource use core elements of financial stewardship (Njoroge & Odhiambo, 2021). This gap in understanding hinders policy development and regulatory reforms needed to strengthen accountability in the sector. Therefore, there is a pressing need to examine the influence of external audit report quality on financial stewardship, with specific focus on the water and sewerage firms in Kenya's Central Rift Region.

## 1.2 Objective of the Study

To examine the influence of external audit reports quality on the financial stewardship of water and sewerage firms in central rift region, Kenya.

## 1.3 Research Hypothesis

**Ho:** Audit report quality has no statistically significant influence on the financial stewardship of water and sewerage firms in central rift region, Kenya.

## 1.4 Significance of the Study

This study holds substantial significance for various stakeholders involved in public utility governance and financial accountability. For water and sewerage firms in Kenya's Central Rift region, the findings offer critical insights into how external audit report quality influences financial stewardship, transparency, and internal control effectiveness. These insights are essential for improving governance structures and enhancing accountability mechanisms within these organizations. Policymakers and regulatory bodies such as WASREB and county governments can leverage the study's evidence-based conclusions to refine regulatory frameworks that uphold high standards of audit quality and financial disclosure. Such reforms are vital in promoting value-for-money and safeguarding public resources. For auditors and professional bodies including ICPAK and the Office of the Auditor General, the study emphasizes the importance of producing high-quality audit reports that support fiscal discipline and ethical financial conduct. It reinforces the need for adherence to international auditing standards and continuous capacity-building among auditors. Development partners and donors, who rely on credible financial stewardship to guide funding decisions,

will find the study relevant in assessing the financial accountability of water utilities, thus supporting sustainable investment in water infrastructure. Academically, the research contributes to the limited body of empirical literature on audit quality and public sector financial management in Kenya, providing a foundation for future research in related areas. Finally, the general public and water consumers benefit indirectly from enhanced financial stewardship, as it leads to more transparent use of funds, better service delivery, and improved infrastructure coverage in essential public utilities.

## 2. Literature Review

This section presents a review of both the theoretical and empirical literature on Service Delivery with a specific interest in Beneficiary Feedback. The theoretical framework encapsulates the reviewed theories, which formed the basis of the study. The empirical studies were reviewed in line with the study objective and were conceptualized into a framework.

### 2.1 Theoretical Review

#### 2.1.1 Agency Theory

This study was grounded in Agency Theory, which offered a robust lens through which to examine the relationship between audit report quality and financial stewardship in public utility organizations. Agency Theory, initially developed by Jensen and Meckling (1976), explained the contractual relationship between principals and agents, where the principal (such as the government, public, or donors) delegated decision-making authority to the agent (in this case, the management and board of directors of water and sewerage companies). A fundamental assumption of the theory was that agents might not always act in the best interests of the principals due to conflicts of interest and information asymmetry (Eisenhardt, 1989).

In the context of publicly owned water and sewerage firms, managers controlled financial resources and operational decisions, while the general public, regulators, and development partners relied on accurate and transparent financial information to evaluate performance and ensure accountability. Without effective oversight, managers could engage in opportunistic behaviors such as misreporting, misallocation of resources, or earnings management, thereby undermining financial stewardship (Fama & Jensen, 1983). Audit reports functioned as a key monitoring mechanism to mitigate agency problems. High-quality audit reports characterized by independence, objectivity, competence, and compliance with auditing standards reduced information asymmetry by providing credible, verified financial information to stakeholders (Watts & Zimmerman, 1986). The assurance provided by such audits reinforced internal controls, enhanced transparency, and deterred financial misreporting, thus promoting sound financial stewardship (DeFond & Zhang, 2014). This theoretical perspective guided the study's investigation into how audit report quality influenced the financial stewardship of water service providers in the Central Rift region of Kenya. By improving the reliability and integrity of financial statements, high-quality audits aligned managerial actions with stakeholder expectations, reduced the likelihood of financial

irregularities, and supported more effective governance. Agency Theory therefore justified the critical role of external audit quality in enhancing public accountability and ensuring value-for-money in the delivery of essential services.

## 2.2 Empirical Review

### 2.2.1 Audit Report Quality on Financial Stewardship

Globally, various studies have investigated the influence of audit report quality on financial stewardship. For instance, Samaie and Nahandi (2018) examined the influence of audit report quality on fraudulent financial reporting in Iran using data from 114 companies listed on the Tehran Stock Exchange. They found that audit quality did not have a statistically significant moderating effect between internal controls and fraudulent financial reporting. Interestingly, their study did not elaborate on the reasons for this non-significant relationship. Similarly, Surbakti and Samosir (2021) conducted a study in Indonesia exploring the moderating role of audit report quality between audit committee characteristics and earnings management (used as a proxy for financial stewardship). They found that although the presence of Big 4 auditors reduced earnings management, the audit report quality did not significantly strengthen the relationship between audit committee tenure and earnings management. This raised concerns about the limitations of even highly reputed audit firms in curbing opportunistic financial behavior.

Within the African context, Arebu (2016) focused on manufacturing firms in Ethiopia and explored how audit report quality affects financial stewardship. The study acknowledged the difficulty of directly measuring audit quality and instead proposed proxies such as the auditors' ability and professionalism in detecting and reporting material misstatements. The findings highlighted that these capabilities are central to audit quality and thus essential to strengthening financial stewardship. Expanding on this, studies like those by Wati et al. (2020), Imene and Imhanzenobe (2020), and Saleh et al. (2020) have reiterated the importance of high audit quality in producing financial statements free from material misstatements. Reliable financial reporting is vital for decision-making and promotes transparency in corporate governance. However, Arebu's (2016) study did not explore the situational or institutional factors that might impair or enhance auditors' capacity to detect such misstatements. In Tunisia, Bacha (2019) assessed the influence of audit quality again proxied by Big 4 membership on internal control and corporate governance among firms listed on the Tunisian Stock Exchange. His findings affirmed that higher audit quality improves internal control systems and helps ensure the integrity of financial statements

## 2.3 Conceptual Framework

The conceptual framework illustrated the relationship between audit report quality and financial stewardship in public utility firms, grounded in agency theory. It identified audit quality indicators such as professionalism, reporting of misstatements, and decision-making influence as key factors affecting financial stewardship outcomes like accountability and transparency. This framework guided the study's

objectives, tool design, and data interpretation. This was captured in Figure 1. Below

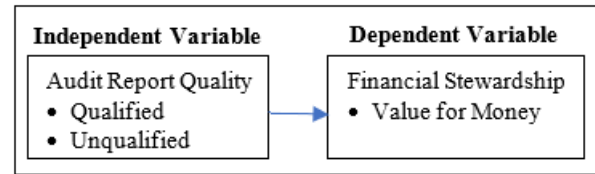


Figure 1: Conceptual Framework

## 3. Research Methodology

This study employed a descriptive research design to explore the relationship between audit report quality and financial stewardship among six key water and sewerage service providers in Kenya's Central Rift region. The target population consisted of 63 senior management staff from Nakuru Water and Sewerage Company, Nakuru Rural Water and Sanitation Company Limited, Naivasha Water and Sewerage Company, Narok Water and Sewerage Services Company, Rift Valley Water Services Board, and the Central Rift Valley Water Works Development Agency. Due to the relatively small population size, a census approach was adopted to ensure full participation. Data were gathered using structured questionnaires, which included both closed-ended and Likert-scale questions divided across six sections covering the study variables.

Instrument reliability was verified through a pilot study conducted in Baringo County, where Cronbach's Alpha values above 0.70 confirmed internal consistency, while content validity was affirmed through expert judgment. Ethical approvals were obtained from the Kabarak University Ethics Review Board and NACOSTI before fieldwork. Questionnaires were administered using the drop-and-pick-later method to enhance response rates. Data analysis incorporated descriptive statistics to summarize trends and a multiple linear regression model to test the influence of audit report quality, external audit findings, past audit actions, and leadership on financial stewardship.

$$Y = \beta_0 + \beta_1 X_1 + \varepsilon$$

The model assessed the influence of audit report quality ( $X_1$ ), on financial stewardship ( $Y$ ). This analytical approach was suitable given the study's focus on evaluating the extent to which the independent variable explained variations in the dependent variable

## 4. Findings of the Study

### 4.1 Response Rate

The response rate is a critical indicator of the reliability and generalizability of research findings. In this study, questionnaires were distributed to senior management staff across water and sewerage service providers within the Central Rift Region of Kenya. A high response rate enhances the credibility of the data collected and minimizes the risk of non-response bias. Evaluating the response rate also provides insight into participant engagement and the effectiveness of

the data collection method used. Results for the response is presented in table 1 below

**Table 1: Response Rate**

| Response Category           | Frequency | Percentage (%) |
|-----------------------------|-----------|----------------|
| Questionnaires Returned     | 60        | 95%            |
| Questionnaires Not Returned | 3         | 5%             |
| <b>Total</b>                | <b>63</b> | <b>100%</b>    |

Out of the 63 questionnaires administered to senior management staff across six water and sewerage utility firms in Kenya's Central Rift Region, 60 were successfully completed and returned, yielding a 95% response rate. This high rate of participation indicated strong engagement from the target respondents and affirmed the reliability and

representativeness of the data collected. According to Mugenda and Mugenda (2008), a response rate above 70% is considered excellent, underscoring the robustness of the study's empirical foundation

### 4.3 Descriptive Statistics

#### 4.3.1 Descriptive Statistics for Audit Report Quality

The respondents were asked to rate their level of agreement with statements on the Audit Report Quality using a five-point Likert scale of 1. Not At All (NA), 2. Small Extent (SE), 3. Moderate Extent (ME), 4. Large Extent (LE) and 5. Very Large Extent (VLE), the results on their level of agreement are presented in table 2 below

**Table 2: Descriptive Statistics for Audit Report Quality**

| Statement                                                                            | NA (1)     | SE (2)     | ME (3)     | LE (4)     | VLE (5)    | Mean        | SD          |
|--------------------------------------------------------------------------------------|------------|------------|------------|------------|------------|-------------|-------------|
| Audit reports are undertaken in a professional manner                                | 5 (8.30%)  | 10 (16.7%) | 8 (13.3%)  | 12 (20.0%) | 25 (41.7%) | 3.7         | 1.37        |
| Material misstatements are always detected in audit report                           | 10 (16.7%) | 12 (20.0%) | 8 (13.3%)  | 6 (10.0%)  | 24 (40.0%) | 3.37        | 1.49        |
| Material misstatements in financial reports are always reported in audit reports     | 5 (8.30%)  | 8 (13.3%)  | 12 (20.0%) | 10 (16.7%) | 25 (41.7%) | 3.7         | 1.3         |
| Noted issues in audit reports are always supported with facts                        | 12 (20.0%) | 10 (16.7%) | 8 (13.3%)  | 20 (33.3%) | 10 (16.7%) | 3.1         | 1.41        |
| Quality levels of audit reports have capacity to influence financial decision making | 5 (8.30%)  | 15 (25.0%) | 14 (23.3%) | 16 (26.7%) | 10 (16.7%) | 3.18        | 1.21        |
| <b>Overall</b>                                                                       |            |            |            |            |            | <b>3.41</b> | <b>1.36</b> |

The findings revealed that respondents generally held moderately positive perceptions of audit report quality, with an overall mean score of 3.41 and a standard deviation of 1.36. The highest-rated aspects included the professionalism of audits and the reporting of material misstatements, both scoring a mean of 3.70, indicating a strong belief in the diligence and integrity of audit practices. However, perceptions varied regarding the consistent detection of material misstatements (mean = 3.37, SD = 1.49) and the factual substantiation of audit findings, which had the lowest mean score of 3.10 and a high standard deviation of 1.41. Additionally, while audit reports were seen to have some influence on financial decision-making (mean = 3.18), the variability in responses pointed to inconsistent experiences. These insights suggest that although audit processes are generally valued, there is room to improve the reliability, influence, and evidentiary support of audit findings to strengthen financial oversight.

### 4.3 Correlation Coefficient

To evaluate the strength and direction of the relationship between audit report quality and financial stewardship, a Pearson correlation analysis was conducted. This statistical technique was chosen to establish whether improvements in audit quality were associated with corresponding enhancements in financial stewardship practices among public utility firms. Results are presented in table 3 below

**Table 3: Correlation Matrix**

| Variables             | Audit Quality | Financial Stewardship |
|-----------------------|---------------|-----------------------|
| Audit Quality         | 1             | 0.841**               |
| Financial Stewardship | 0.841**       | 1                     |

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

The correlation matrix shows a strong positive relationship between audit quality and financial stewardship ( $r = 0.841$ ,  $p < 0.01$ ). This implies that as the quality of audit reports increases, the level of financial stewardship also improves significantly among the public utility firms studied.

### 4.4 Model Summary

A regression model was constructed to determine the predictive ability of audit report quality on financial stewardship. The model summary provided key indicators such as the coefficient of determination ( $R^2$ ), which showed how much of the variance in financial stewardship could be explained by variations in audit report quality. The results are presented in table 4 below

**Table 4: Model Summary**

| Model | R     | R Square | Adjusted R Square | Std. Error of the Estimate |
|-------|-------|----------|-------------------|----------------------------|
| 1     | 0.841 | 0.707    | 0.701             | 0.423                      |

The model explains approximately 70.7% of the variance in financial stewardship ( $R^2 = 0.707$ ). This indicates a high level of explanatory power, suggesting that audit quality is a strong predictor of financial stewardship in the context of the selected public utility firms.

### 4.5 Analysis of Variance (ANOVA)

To assess the overall significance of the regression model, an ANOVA test was conducted. This test determined whether the regression model provided a better fit to the data than a model with no predictors, thereby establishing the statistical significance of audit report quality as a predictor of financial stewardship.

Table 3: ANOVA

| Model      | Sum of Squares | df | Mean Square | F      | Sig. |
|------------|----------------|----|-------------|--------|------|
| Regression | 18.475         | 1  | 18.475      | 103.25 | 0    |
| Residual   | 7.625          | 58 | 0.131       |        |      |
| Total      | 26.1           | 59 |             |        |      |

The ANOVA results indicate that the regression model is statistically significant ( $F(1,58) = 103.25, p < 0.001$ ). This confirms that audit quality has a significant predictive effect on financial stewardship.

#### 4.6 Regression Coefficients

The regression coefficients were examined to assess the individual contribution of audit report quality to financial stewardship. The standardized beta coefficient, along with the associated t-statistic and significance level, indicated the strength and significance of audit report quality as a predictor in the model. These results were used to test the study's hypothesis. Results were presented in table 4 below

Table 4: Regression Coefficients

| Model         | Unstandardized Coefficients | Standardized Coefficients | t     | Sig.   |
|---------------|-----------------------------|---------------------------|-------|--------|
|               | B                           | Std. Error                | Beta  |        |
| (Constant)    | 1.234                       | 0.228                     | –     | 5.412  |
| Audit Quality | 0.278                       | 0.027                     | 0.841 | 10.164 |

The regression coefficient for audit quality ( $B = 0.278, \beta = 0.841, p < 0.001$ ) indicates that a one-unit increase in audit quality leads to a 0.278 unit increase in financial stewardship. The standardized beta shows that audit quality has a strong positive influence on financial stewardship, reaffirming the importance of high-quality audit practices in enhancing accountability in public utility management.

#### 4.7 Hypothesis Testing

##### 4.7.1. Hypothesis:

The study sought to test the following null hypothesis:

***H<sub>0</sub>: Audit report quality has no significant effect on financial stewardship among water and sewerage utility firms in the Central Rift Region of Kenya.***

To test this hypothesis, a simple linear regression model was employed, where audit report quality was the independent variable and financial stewardship was the dependent variable. The results from the regression analysis are summarized below: Pearson correlation coefficient ( $r$ ) = 0.841, indicating a strong positive linear relationship between audit report quality and financial stewardship. R-squared ( $R^2$ ) = 0.707, showing that 70.7% of the variation in financial stewardship is explained by the quality of audit reports. F-statistic = 103.25, with a p-value = 0.000, which is less than 0.05, indicating that the overall regression model was statistically significant. Regression coefficient ( $B$ ) = 0.278, with a t-value = 10.164 and p-value = 0.000. This means that audit quality had a statistically significant positive effect on financial stewardship. Since the p-value (0.000) was less than the significance level of 0.05, the null hypothesis was rejected. The study therefore concluded that audit report quality has a statistically significant positive effect on financial stewardship among water and sewerage firms in the Central Rift Region. This finding highlights the critical role

that high-quality audit reports play in promoting transparency, accountability, and prudent financial management in the public utility sector.

#### 5. Summary, Conclusions and Recommendations

##### 5.1 Summary of Findings

The study found that audit report quality significantly influenced financial stewardship among water and sewerage service providers in Kenya's Central Rift Region. A strong positive correlation ( $r = 0.841$ ) was established, indicating that higher audit quality is associated with improved financial oversight and accountability. Regression analysis revealed that audit report quality accounted for approximately 70.7% of the variance in financial stewardship, with a statistically significant beta coefficient ( $\beta = 0.278, p < 0.05$ ). Respondents generally perceived audit reports as professionally conducted and useful for decision-making, though some inconsistencies were noted in the detection and substantiation of audit findings. These results underscore the critical role of high-quality audit practices in enhancing transparency, enforcing internal controls, and ensuring responsible financial management in public utility organizations.

##### 5.2 Conclusions

The study concluded that audit report quality plays a vital role in promoting financial stewardship within public utility firms, particularly water and sewerage service providers in Kenya's Central Rift Region. The strong positive relationship between audit quality and financial stewardship suggests that professionally executed audits, which accurately report material misstatements and provide factual evidence, contribute significantly to accountability and transparency in financial management. While perceptions of audit effectiveness were generally positive, variations in responses pointed to areas needing improvement, such as the consistency of detecting and substantiating audit issues. Overall, enhancing audit quality can serve as a strategic tool for strengthening internal controls, fostering fiscal discipline, and reinforcing public trust in utility governance.

##### 5.3 Recommendations

###### 5.3.1 Recommendations for Policy

Based on the findings, the study recommends that policymakers, particularly within regulatory bodies such as WASREB and county governments, should strengthen policies that enforce audit quality standards across all water and sewerage service providers. This includes mandating adherence to international auditing standards, enhancing auditor independence, and requiring timely implementation of audit recommendations. In addition, regulatory frameworks should incorporate mechanisms for continuous auditor training, routine quality reviews, and sanctions for non-compliance to improve the credibility and effectiveness of audit reports. Strengthening these policies will enhance financial stewardship, promote transparency, and ensure public resources are utilized efficiently within the water utility sector.

### 5.3.2 Recommendations for Decision Making

The study recommends that management boards and senior executives of water and sewerage service providers integrate audit report findings into their strategic and operational decision-making processes. This entails reviewing audit reports comprehensively, addressing identified weaknesses, and aligning organizational policies with audit recommendations to improve financial governance. By leveraging audit insights, decision-makers can enhance internal controls, prioritize risk mitigation, and allocate resources more effectively. Furthermore, institutionalizing a culture of accountability and responsiveness to audit outcomes will support long-term sustainability and foster stakeholder confidence in the financial integrity of these public utilities.

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