

The Relationship between Corporate Governance and Audit Fees

**A Case Study of Non-Financial Companies listed on the Nairobi
Securities Exchange**

Nyamosi Wilson Omwoyo (008634)

**Submitted in partial fulfillment of the requirements for the Degree of Master
of Commerce at Strathmore University**

**School of Management and Commerce
Strathmore University
Nairobi, Kenya**

JUNE 2012

This thesis is available for Library use on the understanding that it is copyright material. No quotation from the thesis may be published without proper acknowledgement.

DECLARATION

I declare that this work has not been previously submitted and approved for the award of a degree by this or any other University. To the best of my knowledge and belief, the thesis contains no material previously published or written by another person except where due reference is made in the thesis itself.

Nyamosi Wilson Omwoyo

Signed:

28th June 2012.

Approval

The thesis of Nyamosi Wilson Omwoyo was reviewed and approved by the following:

Name of Supervisor: Dr. James Boyd McFie

Faculty affiliation: Academic and Research Director

Institution: Strathmore University

Head of School: Mr. David Wang'ombe

School Name: School of Management and Commerce

Dean, School of Graduate Studies: Professor Ruth Kiraka

ABSTRACT

This thesis consisted of two empirical studies. First, it examined the relationship between corporate governance mechanisms (relating to boards' of directors characteristics) and audit fees in the Kenyan context. Secondly, the study also examined compliance with the corporate governance disclosure requirements for listed companies in Kenya. The purpose of the study was firstly, to contribute to understanding how various boards' of directors characteristics as required by the Capital Markets Act, *Chapter 485A of the Laws of Kenya, (2002)*, affect external audit fees in Kenya. Secondly, the study sought to explore corporate governance disclosure aspects of listed companies in Kenya. The study adopted the pooled ordinary least squares regression model for a sample of thirty non-financial listed companies out of a population of fifty-three companies listed on the Nairobi Securities Exchange at the time the study was done. The multivariate regression results suggest that board expertise and board size are positively related to audit fees. The other characteristics of board independence and board diligence provide inconsistent results with audit fees. The control variables of total assets and complexity are significant; the financial risk and company leverage variables are found to be insignificantly related to audit fees. On the adequacy of corporate governance disclosure by listed companies in Kenya, a good system of corporate governance requires a good level of disclosure and adequate information to reduce information asymmetries between parties. The degree of disclosure results show that eight companies, that is, 26.6% have a corporate governance disclosure index of between 81% and 100%. This means that 73.4% of the companies in the sample did not attain the adequacy level; thus, the corporate governance disclosure level in Kenya is low. With regard to the relationship between boards' of directors characteristics and the level of corporate governance disclosure compliance by listed companies in the Kenyan securities market, the multivariate regression results suggest that board independence is positively related to the level of corporate governance disclosure. The study finds no evidence that board diligence, board expertise and board size are related to the level of corporate governance disclosure compliance by listed companies. The control variables of total assets, company leverage and industry type 1 are significant; industry type 2, industry type 3 and industry type 4 are found to be insignificantly related to the level of corporate governance disclosure.

Keywords: Audit fees; Corporate governance; Boards' of directors characteristics; Corporate governance disclosure.

TABLE OF CONTENTS

DECLARATION	II
ABSTRACT	III
TABLE OF CONTENTS	IV
LIST OF TABLES.....	VIII
LIST OF FIGURES.....	IX
ABBREVIATIONS.....	X
ACKNOWLEDGEMENTS	XI
CHAPTER 1.....	1
INTRODUCTION	1
1.1 BACKGROUND.....	1
1.2 CORPORATE GOVERNANCE DISCLOSURE IN KENYA	5
1.3 PROBLEM STATEMENT	5
1.4 RESEARCH OBJECTIVES AND QUESTIONS.....	6
1.5 RESEARCH JUSTIFICATION AND MOTIVATION	7
1.6 SCOPE OF RESEARCH	8
1.7 SIGNIFICANCE OF THE STUDY	8
1.8 ORGANIZATION OF THE THESIS	8
CHAPTER 2.....	10
LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT.....	10
2.1 INTRODUCTION	10
2.2 THEORIES USED IN THE STUDY	10
2.2.1 AGENCY THEORY	10
2.2.2 ECONOMIC THEORY OF AUDITING	11
2.3 CORPORATE GOVERNANCE.....	12
2.4 THE CAPITAL MARKETS ACT, 2002; GUIDELINES ON CORPORATE GOVERNANCE PRACTICES.....	12
2.5 EXTANT RESEARCH AND HYPOTHESES DEVELOPMENT.....	14
2.6 AUDIT FEES AND CORPORATE GOVERNANCE	14
2.6.1 AUDIT FEES AND BOARD INDEPENDENCE	15
2.6.2 AUDIT FEES AND BOARD DILIGENCE.....	16
2.6.3 AUDIT FEES AND BOARD EXPERTISE	17
2.6.4 AUDIT FEES AND BOARD SIZE	18
2.7 CONTROL VARIABLES RELATED TO AUDIT FEES.....	19
2.7.1 COMPANY SIZE.....	19
2.7.2 FINANCIAL RISK	20
2.7.3 COMPLEXITY.....	21
2.7.4 COMPANY LEVERAGE.....	21
2.8 CONCEPTUAL FRAMEWORK (DEPENDENT VARIABLE - AUDIT FEES)	22

2.8.1	OPERATIONALIZATION OF VARIABLES – AUDIT FEES AND BOARDS’ OF DIRECTORS CHARACTERISTICS ...	22
2.8.2	MODEL SPECIFICATION: AUDIT FEES AND CORPORATE GOVERNANCE	24
2.9	CORPORATE GOVERNANCE DISCLOSURE	26
2.9.1	CORPORATE GOVERNANCE DISCLOSURE AND BOARD INDEPENDENCE.....	27
2.9.2	CORPORATE GOVERNANCE DISCLOSURE AND BOARD DILIGENCE.....	28
2.9.3	CORPORATE GOVERNANCE DISCLOSURE AND BOARD EXPERTISE	28
2.9.4	CORPORATE GOVERNANCE DISCLOSURE AND BOARD SIZE	28
2.10	CONTROL VARIABLES RELATED TO CORPORATE GOVERNANCE DISCLOSURE.....	29
2.10.1	COMPANY SIZE.....	29
2.10.2	COMPANY LEVERAGE.....	29
2.10.3	INDUSTRY TYPE	30
2.11	CONCEPTUAL FRAMEWORK (DEPENDENT VARIABLE - CORPORATE GOVERNANCE DISCLOSURE).....	30
2.11.1	OPERATIONALIZATION OF VARIABLES – CORPORATE GOVERNANCE DISCLOSURE AND BOARDS’ OF DIRECTORS CHARACTERISTICS	31
2.11.2	MODEL SPECIFICATION: CORPORATE GOVERNANCE DISCLOSURE AND BOARDS’ OF DIRECTORS CHARACTERISTICS.....	34
2.12	CHAPTER SUMMARY	35
CHAPTER 3.....		37
RESEARCH METHODOLOGY		37
3.1	INTRODUCTION	37
3.2	RESEARCH DESIGN	37
3.3	DATA SET AND SAMPLE	38
3.4	DATA SOURCES AND COLLECTION METHODS	39
3.5	DATA ANALYSIS PROCEDURES	39
3.5.1	DESCRIPTIVE STATISTICS	39
3.5.2	UNIVARIATE ANALYSIS	39
3.5.3	MULTIVARIATE ANALYSIS	39
3.5.4	TEST FOR THE VALIDITY OF THE MODEL.....	40
3.6	CHAPTER SUMMARY	40
CHAPTER 4.....		42
RESULTS AND DISCUSSIONS: THE RELATIONSHIP BETWEEN BOARDS’ OF DIRECTORS CHARACTERISTICS AND AUDIT FEES.....		42
4.1	INTRODUCTION	42
4.2	INITIAL DATA ANALYSIS (DEPENDENT VARIABLE - AUDIT FEES).....	42
4.2.1	SAMPLE REPRESENTATION	42
4.2.2	DESCRIPTIVE STATISTICS (AUDIT FEES).....	43
4.2.3	UNIVARIATE ANALYSIS (AUDIT FEES)	44
4.2.4	MULTIVARIATE ANALYSIS (AUDIT FEES).....	45
4.2.5	TEST FOR RELIABILITY OF THE MODEL (AUDIT FEES).....	46
4.2.6	SUMMARY FINDINGS (AUDIT FEES)	47
4.2.7	CHAPTER SUMMARY	48
CHAPTER 5.....		49

RESULTS AND DISCUSSIONS: COMPLIANCE WITH THE CORPORATE GOVERNANCE DISCLOSURE REQUIREMENT ASPECTS.....	49
5.1 INTRODUCTION	49
5.2 ADEQUACY OF CORPORATE GOVERNANCE DISCLOSURE BY LISTED COMPANIES IN KENYA	50
5.2.1 CORPORATE GOVERNANCE DISCLOSURE SCORE	50
5.2.2 DEGREE OF CORPORATE GOVERNANCE DISCLOSURE (IN PERCENTAGE).....	51
5.3 THE RELATIONSHIP BETWEEN BOARDS' OF DIRECTORS CHARACTERISTICS AND THE LEVEL OF CORPORATE GOVERNANCE DISCLOSURE COMPLIANCE	52
5.3.1 DESCRIPTIVE STATISTICS FOR CORPORATE GOVERNANCE DISCLOSURE INDEX	52
5.3.2 UNIVARIATE ANALYSIS (CORPORATE GOVERNANCE DISCLOSURE).....	53
5.3.3 MULTIVARIATE ANALYSIS (CORPORATE GOVERNANCE DISCLOSURE)	54
5.3.4 TEST FOR RELIABILITY OF THE MODEL (CORPORATE GOVERNANCE DISCLOSURE).....	56
5.3.5 SUMMARY FINDINGS (CORPORATE GOVERNANCE DISCLOSURE).....	56
5.3.6 CHAPTER SUMMARY	57
CHAPTER 6.....	59
SUMMARY AND CONCLUSIONS	59
6.1 GENERAL	59
6.2 RESEARCH FINDINGS (AUDIT FEES).....	59
6.3 RESEARCH FINDINGS (CORPORATE GOVERNANCE DISCLOSURE).....	60
6.4 CONTRIBUTIONS	60
6.5 LIMITATIONS OF THIS STUDY	61
6.6 RECOMMENDATIONS FOR FURTHER RESEARCH (AUDIT FEES AND CHARACTERISTICS OF BOARDS OF DIRECTORS)	62
6.7 RECOMMENDATIONS FOR FURTHER RESEARCH (CORPORATE GOVERNANCE DISCLOSURE AND CHARACTERISTICS OF BOARDS OF DIRECTORS)	63
REFERENCES	64
APPENDICES.....	77
APPENDIX 1: NON- FINANCIAL PUBLIC LISTED COMPANIES INCLUDED IN THE SAMPLE AT THE TIME OF CARRYING OUT THE STUDY	77
APPENDIX 2: NON- FINANCIAL PUBLIC LISTED COMPANIES EXCLUDED IN THE SAMPLE AT THE TIME OF CARRYING OUT THE STUDY	78
APPENDIX 3: ANALYSIS OF VARIANCE^B FOR MODEL 1	78
APPENDIX 4: PEARSON CORRELATIONS COEFFICIENTS FOR THE VARIABLES USED IN THE REGRESSION (LNFEED).....	79
APPENDIX 5: CORPORATE GOVERNANCE DISCLOSURE SCORE BY COMPANIES FOR ALL YEARS OF THE STUDY	80
APPENDIX 6: PEARSON CORRELATIONS COEFFICIENTS FOR THE VARIABLES USED IN THE REGRESSION (CGDI).....	81
APPENDIX 7: ANALYSIS OF VARIANCE^B FOR MODEL 2 (DEPENDENT VARIABLE – CGDI).....	81
APPENDIX 8: SUMMARY OF DISCLOSURE REQUIREMENTS (GUIDELINES ON GOVERNANCE PRACTICES BY PUBLIC LISTED COMPANIES IN KENYA) OF GAZETTE NOTICE NO. 3362, 14 MAY 2002, THE CAPITAL MARKETS ACT, 2002.....	82

APPENDIX 9: SUMMARY OF THE REQUIREMENTS OF THE SIXTH SCHEDULE TO THE KENYA COMPANIES ACT AND SECTIONS 197 AND 198 OF THE ACT.....	83
APPENDIX 9 (CONTINUED): SUMMARY OF THE REQUIREMENTS OF THE SIXTH SCHEDULE TO THE KENYA COMPANIES ACT AND SECTIONS 197 AND 198 OF THE ACT	84

LIST OF TABLES

Table 2.1: Dependent and independent variables (audit fees).....	23
Table 2.2: Control variables related to audit fees	24
Table 2.3: Summary guidelines on corporate governance practices by public listed companies in Kenya used in the study	32
Table 2.4: Dependent and independent variables (corporate governance disclosure).....	33
Table 2.5: Control variables related to corporate governance disclosure	34
Table 3.1: Number of companies studied	38
Table 4.1: Sample representation by Sector (Dependent variable – audit fees)	42
Table 4.2: Frequency table of listed companies across all the years	43
Table 4.3: Descriptive statistics of the variables across all companies	43
Table 4.4: Pearson correlation coefficients for the variables in the model - LNFEED).....	45
Table 4.5: Linear regression results for model 1	45
Table 4.6: Regression analysis for the audit fees model.....	46
Table 4.7: Summary findings on hypotheses-Boards’ of directors characteristics and audit fees	48
Table 5.1: Sample representation by Sector (Dependent variable - corporate governance disclosure index)	49
Table 5.2: Frequency table of listed companies across all the years	50
Table 5.3: Corporate governance disclosure score by companies (Corporate governance disclosure index)	51
Table 5.4: The degree of disclosure (in percentage) for companies included in the sample.....	52
Table 5.5: Descriptive statistics for corporate governance disclosure index for all companies	53
Table 5.6: Pearson correlations coefficients for the variables in the model	54
Table 5.7: Linear regression results for model 2	55
Table 5.8: Regression analysis for the corporate governance disclosure model....	55
Table 5.9: Summary findings on the hypotheses (Corporate governance disclosure)	57

LIST OF FIGURES

Figure 2.1: The Conceptual model for audit fees	22
Figure 2.2: The Conceptual model for corporate governance disclosure	30

ABBREVIATIONS

AIMS	Alternative Investment Market Segment
BODD	Board Diligence
BODE	Board Expertise
BODI	Board Independence
BODS	Board Size
CEO	Chief Executive Officer
CGDI	Corporate Governance Disclosure Index
CMA	Capital Markets Authority
DC	District of Columbia
FR	Financial Risk
IASB	International Accounting Standards Board
ICPAK	Institute of Certified Public Accountants of Kenya
IFAC	International Federation of Accountants
IFRSs	International Financial Reporting Standards
IT	Industry Type
INVRECTA	(Inventory and Receivables) to Total Assets
ISAR	International Standards of Accounting and Reporting
LEV	Leverage
LNFEED	Natural Log of Audit Fees
LNTA	Natural Log of Total Assets
MIMS	Main Investment Market Segment
NACD	National Association of Corporate Directors
NSE	Nairobi Securities Exchange
OECD	Organization for Economic Cooperation and Development
POLS	Pooled Ordinary Least Squares
SEC	Securities Exchange Commission
SES	Society of Educators and Scholars
SPSS	Statistical Package for the Social Sciences
UK	United Kingdom
VIF	Variance Inflation Factor
USA	United States of America

ACKNOWLEDGEMENTS

I thank Almighty God for granting me the energy to carry out this study. Secondly, I thank Strathmore University for granting me an opportunity to undertake the Master of Commerce studies. I wish to express my sincere gratitude to my thesis supervisor, Dr. James B. McFie, for his advice, guidance and useful suggestions towards the improvement of this study. Special thanks go to Mr. David Wang'ombe for his useful comments on the relevance of this study. I also thank Dr. Monica Kerretts for her valuable comments and guidance on the initial proposal and suggestions on the re-organization and structure of this thesis.

I also give special thanks to my spouse, Rose Kemunto and sons, Victor, Owain and Brighton, for their support and encouragement during the period of this study. Special recognition goes to my mother, Peninah Kemunto and my late father, Samson Nyamosi Mogusu, for giving me the inspiration to study.

CHAPTER 1

INTRODUCTION

1.1 Background

‘Good corporate governance can be defined as the process and structure used to direct and manage the business affairs of the company to enhance prosperity and corporate accounting with the ultimate objective of realizing shareholders’ long-term value while taking into account the interest of other stakeholders’ (CMA, 2002).

The principles of the Organization for Economic Co-operation and Development (OECD) on corporate governance constitute a balanced benchmark for corporate governance; they are intended to assist OECD and non-OECD governments in their efforts to evaluate and improve the legal, institutional and regulatory framework for corporate governance in their countries. They also provide guidance and suggestions for stock exchanges, investors and corporations (OECD, 2004).

Larcker et al., (2007), assert that corporate governance mechanisms influence the decisions made by managers when there is separation of ownership and control, in order to enhance accountability and efficiency, and to ensure the quality of the financial reporting process. This separation of corporate ownership from management results in an information gap (Berle and Means, 1932). This information gap necessitates the demand for forms of control and of monitoring, both internally, through the boards of directors, and externally, through the report of the external auditors (Walsh and Seward, 1990).

Many variables may constitute yardsticks by which corporate governance is measured in an organization. In this study, the aspects of corporate governance that are examined are boards’ of directors characteristics, that is, board independence, board diligence, board expertise and board size. Boards of directors have been identified as the central internal control mechanism for monitoring management’s activities (Fama, 1980; Vafeas, 2005; Hay et al., 2008; Carcello, 2009), and are responsible for the oversight of an organization’s performance, with the purpose of maximizing shareholder value (Denis and McConnell, 2003).

The choice of boards’ of directors characteristics addresses the issue of corporate governance and audit fees; the other aspects of corporate governance mechanisms are the audit committee

characteristics whose variables are similar to boards' of directors characteristics. Cohen et al., (2004), suggest that consideration of the audit committee in isolation from the board may be problematic, since boards of directors are responsible for selecting audit committee members and, without support from boards, audit committees would not be able to effectively monitor companies. Therefore, the inclusion of audit committee variables would increase the number of variables under study.

Since the variables for boards' of directors characteristics and audit committee characteristics are similar, a factor analysis would have to be used to reduce the large number of variables into a smaller number of factors, if audit committee variables are included in the study. Factor analysis extracts maximum common variables from all board and audit committee variables, and puts them into a common score. Because of that, audit committee variables are not considered in this study.

The role of the board as stated by the National Association of Corporate Directors (NACD) is that a 'professional boardroom culture requires that the governance process be collectively determined by individual board members', who possess characteristics including independence, diligence and expertise (NACD, 1996). A study by Conger et al., (1998), also mentions director independence, diligence and expertise as the key ingredients necessary for the board to discharge its monitoring function effectively.

The quality of board oversight has received increasing attention in recent years, with emphasis on the need for strong corporate governance (McConomy and Bujaki, 2000). A study by Cadbury, (1997), shows that countries around the world put emphasis on good corporate governance mechanisms and have drawn up guidelines and codes of practice to strengthen corporate governance mechanisms. The International Federation of Accountants states the rationale for this emphasis on good corporate governance is due to increased concerns over the integrity of securities markets (IFAC, 2010).

Good corporate governance practices by boards of directors influence the quality of financial reporting, which in turn has an impact on investor confidence (Adeyemi and Fagbemi, 2010). Saudagaran, (2003), suggests that improving the integrity of financial reporting through greater accountability and the restitution of resources devoted to the audit function can be done by better

corporate governance policies. Fama, (1980), states that the essence of good corporate governance is the outcome of logical and rational decisions taken at the board level.

Boards of directors are being held to higher performance and many groups have called for greater emphasis on the independence, diligence and expertise of corporate board members (NACD, 1996). Boards of directors can influence the level of audit assurance by exercising decision rights and executing corporate governance responsibilities (Abbott et al., 2003); a more independent, diligent and expert board may demand differentially higher audit quality, which requires more audit work. Directors have an investment in reputation capital and are concerned about the possible liability that may arise from financial report misstatements (Eichenseher and Shields, 1985).

Cadbury, (1992), views the auditor's report as one of the corner stones of corporate governance. In addition, Peel and Clatworthy, (2001), highlight that the audit report contributes significantly towards effective governance of modern companies. A sizeable number of studies in developed economies have examined the relationship between corporate governance mechanisms and audit fees. These studies include O'Sullivan and Diacon, (1994), Short et al., (1999), Peel and Clatworthy, (2001), Clatworthy and Peel, (2006), and Yatim et al., (2006).

Research findings by O'Sullivan, (2000), Carcello et al., (2002), and Hay and Knechel, (2004), indicate that audit fees are positively related to the quality of corporate governance, which runs counter to intuition, since good corporate governance would improve the control environment of a company, and could be expected to lead to lower audit fees. However, it can also be argued that companies with strong corporate governance structures demand additional assurance from their auditor in order to preserve their reputation against questionable financial reporting decisions made by management and to avoid potential litigation, thus resulting in higher audit fees (Carcello et al., 2002; Abbott et al., 2003; Goodwin-Stewart and Kent, 2006).

Auditors regard corporate governance as an internal control mechanism which influences the nature and extent of audit testing (Tsui et al., 2001; Muniandy, 2007). A higher level of risk of financial misreporting would increase the extent of tests, resulting in higher audit fees (Bedard and Johnstone, 2004). Hay and Knechel, (2004), argue that the demand for auditing is a function

of the set of risks perceived by individual stakeholders in a company and the set of control mechanisms that are available for mitigating those risks.

For companies that have strong corporate governance, auditors will reduce their audit-risk assessment; they would consequently reduce their audit testing, which in turn leads to lower audit fees (Yatim et al., 2006). The more risky and complex a client is, the more the audit effort and time required to gather the necessary audit evidence that could aid in the formation of an appropriate audit opinion and consequently raise the auditor's fees (Goodwin-Stewart and Kent, 2006).

Auditors who perceive higher client risks would increase their audit effort, resulting in higher audit fees (Goodwin-Stewart and Kent, 2006). Conversely, if auditors perceive lower client risks, then audit effort and fees reduce. Studies by Beasley, (1996), Dechow et al., (1996), Klein, (2002), Abbott et al., (2004), and Krishnan, (2005), show that the strength of boards of directors is significantly associated with the quality of internal controls and of financial reports. A strong and independent board gives greater assurance that internal controls and compliance processes are operating effectively, and financial reports are less likely to contain material misstatements. In such cases, the external auditors could reduce their audit effort, resulting in lower audit fees; the converse will hold if auditors perceive weak corporate governance.

In Kenya, the auditor is appointed at each annual general meeting to hold office from the conclusion of that, until the conclusion of the next annual general meeting [Section 159(1) of the Kenyan Companies Act, *Chapter 486 of the Laws of Kenya*]. The remuneration of the auditors is fixed by the directors through the authority of the shareholders at the annual general meeting of the company. Corporate governance is specifically of interest to investors because it serves to protect their interests and wealth in the companies in which they have invested.

The Institute of Certified Public Accountants of Kenya (ICPAK), established under the Accountants Act, *Chapter 531 of the Laws of Kenya*, and listed as a member of the International Federation of Accountants (IFAC) on the IFAC website, is the accounting and auditing standard-setting body in Kenya. In 1997, the council of ICPAK decided that financial statements covering periods beginning on or after January 1, 1999, have to be prepared in accordance with International Accounting Standards (IASs) (World Bank, 2001). IASs must be used in preparing

financial statements for enterprises of all types and sizes, both listed and non-listed (IASB, 2001). In order to enforce adherence to the highest standards of financial reporting, the ICPAK maintains a close working relationship with the Capital Markets Authority; the ICPAK is represented on the Disclosure and Standards Committee of the Capital Markets Authority.

1.2 Corporate governance disclosure in Kenya

The framework for corporate governance disclosure in Kenya comprises legal and regulatory requirements; the Companies Act (*Chapter 486 of the Laws of Kenya*) is the first piece of legislation governing corporate governance disclosure. In terms of corporate governance disclosure requirements, the Act addresses at considerable length issues pertaining to disclosures to be made in a prospectus, annual returns, accounts and audit, disclosures on matters pertaining to directors, registers and inspections, and general meetings (Kenyan Companies Act, 1962).

The Kenyan Companies Act, (1962), sets out some disclosure requirements for financial accounting and reporting by all companies registered in Kenya, and stipulates the minimum requirements with regard to financial reporting. The Sixth Schedule of the Act and sections 197 and 198 set out disclosure requirements in respect of statement of financial position and statement of comprehensive income.

In 2002, the Capital Markets Authority, working with the then Nairobi Stock Exchange, developed a new legal and regulatory framework that conforms to best international practices. Of the rules so developed, the key ones in ensuring corporate disclosure by listed companies include the Nairobi Stock Exchange Listing Manual, the Capital Markets (Securities) (Public Offers, Listing and Disclosures) Regulations (2002), and the Capital Markets guidelines on corporate governance practices by listed companies in Kenya.

1.3 Problem statement

The external audit represents a crucial element of a company's internal control system; it provides a check and balance system that helps shareholders to monitor and control managements' activities (Solomon, 2007). Boards of directors can influence the level of audit assurance by exercising decision rights and executing corporate governance responsibilities (Abbott et al., 2003); a more independent, diligent and expert board may demand differentially higher audit quality, which requires more audit work. However, a more diligent board may

ensure that other internal controls are more efficient, with the result that the work needed to be performed by the external auditor is reduced. Hence, it is not clear whether the competence of boards of directors is negatively or positively related to the size of audit fees. This thesis aims at examining the nature of this relationship between the characteristics of boards of directors and the size of audit fees.

In 2002, legislation was passed requiring listed companies in Kenya to practise certain corporate governance features and disclose whether or not they comply with a set of detailed measures to bring the level of governance in line with international standards. This thesis seeks to examine the extent to which listed companies on the Nairobi Securities Exchange have followed the corporate governance features and whether the level of corporate governance disclosure by listed companies in the Kenyan securities market can be described as adequate.

The increase of corporate governance disclosure in recent years' annual reports can be interpreted as a way by which companies keep the shareholders' trust in them; compliance with the disclosure requirements is taken as a proxy for compliance with the corporate governance general requirements. Hence, it is of interest to enquire whether there is any relationship between boards' of directors characteristics and the level of corporate governance disclosure.

1.4 Research objectives and questions

The main objective of this study is to contribute to understanding how various boards' of directors characteristics affect external audit fees in Kenya. In addition, the study seeks to understand the extent of corporate governance disclosure aspects of listed companies in Kenya.

The specific objectives are:

1. To find out the relationship between boards' of directors characteristics and audit fees in Kenya.
2. To examine whether the level of corporate governance disclosure by listed companies in Kenya can be described as adequate.
3. To find out the relationship between boards' of directors characteristics and the level of corporate governance disclosure compliance by listed companies on the Nairobi Securities Exchange.

The study intends to answer the following research questions:

1. What is the relationship between boards' of directors characteristics and audit fees?
2. Is the level of corporate governance disclosure by listed companies in Kenya adequate?
3. What is the relationship between boards' of directors characteristics and the level of corporate governance disclosure compliance by listed companies on the Nairobi Securities Exchange?

1.5 Research justification and motivation

The importance of auditing can be illustrated by the principal-agent relationship. The demand for the external audit is directly related to the fact that the directors (agents) are the ones who prepare the financial statements. Most of the previous studies on the relationship between boards' of directors characteristics and audit fees have been done in developed countries and a few countries from emerging markets.

The motivation for this study is the significant changes in the regulatory environment for listed companies brought about by the introduction and adoption of guidelines on corporate governance practices by public listed companies on the Nairobi Securities Exchange. This study is important because there have been extensive improvements on laws and regulations imposed by the Capital Markets Authority, through the introduction of guidelines on corporate governance practices aimed at facilitating good corporate governance mechanisms in Kenya.

Therefore, this research will benefit any person or company that is interested in the study or the progress of corporate governance in the Kenyan securities market. The study contributes to the governance literature by providing empirical evidence on this important topic and offering guidance to companies examining internal control processes aimed at improving boards' of directors overall expertise. As a result, it will provide data on corporate governance practices in Kenya after the adoption of the corporate governance reforms required by the Capital Markets Authority.

This study will also be useful to stakeholders on the Nairobi Securities Exchange as it will provide evidence on the relationship between boards' of directors characteristics and audit fees, the impact of boards' of directors characteristics have on audit fees. In addition, the study will provide information on the adequacy of the corporate governance disclosure level and on the

relationship between boards' of directors characteristics and the level of corporate governance disclosure compliance by listed companies in the Kenyan securities market.

1.6 Scope of Research

The study focuses on non-financial companies listed on the Nairobi Securities Exchange (NSE) for the period 2003 to 2009. The study considers the period 2003 to 2009 to be appropriate because these are the years after the introduction of the corporate governance guidelines for listed companies in Kenya. In addition, the study also explores the relationship between boards' of directors characteristics and the level of corporate governance disclosure compliance by listed companies on the Nairobi Securities Exchange; it also seeks to examine whether corporate governance disclosure by listed companies in Kenya is adequate.

1.7 Significance of the study

The principal-agent problem in the context of the demand for auditing has been widely studied and this relationship illustrates the importance of auditing (Chow, 1982; Watts and Zimmerman, 1983; Francis and Wilson, 1988). This study provides useful information for improving the audit function, as it provides evidence on the relationship between boards' of directors characteristics and audit fees. The study contributes to the audit fee literature by providing additional evidence on, and enhancing our understanding of the complex relationships between boards' of directors characteristics and audit fees.

In addition, the study seeks to examine whether corporate governance disclosure by listed companies can be described as adequate and the relationship between boards' of directors characteristics and the level of corporate governance disclosure compliance by listed companies on the Nairobi Securities Exchange. The study is also important to other researchers and academicians as it provides an incentive to carry out further research into the same or related subject matters.

1.8 Organization of the thesis

This thesis is organized into six chapters. Chapter 1 introduces the background of the thesis. Chapter 2 reviews the relevant prior research and literature in the field of boards' of directors characteristics and audit fees; it also reviews literature on corporate governance disclosure. Chapter 3 describes the research methodology: the research design, data set and sample, data

sources and collection methods, and data analysis. Chapter 4 presents the results and discussions on the relationship between boards' of directors characteristics and audit fees. Chapter 5 presents the results and discussions on compliance with the corporate governance disclosure requirement aspects. Finally, chapter 6 summarizes the results and provides the conclusions of the study.

CHAPTER 2

LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT

2.1 Introduction

This chapter provides the theoretical framework for the present study. The main discussion is on agency theory that highlights the relationship between principals and agents and the conflict that arises between them because of their different goals. As part of reducing the agency conflict, the monitoring roles of boards' of directors as well as that of the external audit are required. The chapter presents the relevant prior studies on the relationship between boards' of directors characteristics and audit fees; it also presents a literature review on corporate governance disclosure practices and model specifications.

2.2 Theories used in the study

This study is based on two theories, agency theory and the economic theory of auditing. The monitoring roles of boards of directors and auditors are studied as mechanisms that mitigate agency conflicts. Zahra and Pearce, (1989), suggest that agency theory is the most comprehensive theory that clarifies the boards' of directors functions and highlights the importance of their controlling role. Solomon, (2007), finds that the external audit represents another crucial element of a company's internal control system; it provides a check and balance system that helps shareholders to monitor and control managements' activities.

2.2.1 Agency theory

The first theory under consideration is agency theory, which explains the relationship between the principal and the agent. Agency theory holds that there exist conflicts between managers, who are the agents, and shareholders, who are the principals. Agency theory, according to Jensen and Meckling, (1976), defines the agency relationship as a contract under which one or more persons (the principal) engage another person (the agent) who performs some service on their behalf.

This principal-agent relationship also involves delegating some decision-making authority to the agent; accordingly, Jensen and Meckling, (1976), assert that agency theorists have focused upon

the managerial incentive problems that emerge, because of the separation of the ownership of a company and managerial decision-making. Bushman et al., (2004), postulate that corporate governance is in place to monitor management's behaviour and evaluate management's performance to ensure managers are disciplined to act in the best interests of shareholders.

Wallace, (1991), explains that the demand for auditing stems from the principal-agent relationship; agents and principals are assumed to act primarily considering their own self-interest, which is to maximize their own utility. Eilifsen et al., (2009), find that managers may favour entity growth at the expense of the owners because of the bonuses that the managers receive; managers could manipulate the reported performance in order to get larger bonuses. According to agency theory, managers have incentives to misreport the financial statements resulting from the conflict of interests between managers and shareholders (Carcello et al., 2002; Abbott et al., 2003).

2.2.2 Economic theory of auditing

Simunic and Stein, (1996), developed the economic framework in their study on audit fees. This study uses a similar framework; the economic theory of auditing states that audit fees reflect an economic cost of external auditors to organizations and this economic cost varies considerably with the size, complexity and riskiness of the audited entity (Simunic and Stein, 1996). Taylor, et al., (1997), say that the need for an audit arises because shareholders need to ensure that the directors are carrying out their role as expected and that they are not maximizing their benefits at the expense of shareholders.

The Cadbury Report, (1992), states: 'The annual audit is one of the cornerstones of corporate governance. The audit provides an external and objective check on the way in which financial statements have been prepared and presented, and it is an essential part of checks and balances required'. A study by Eilifsen et al., (2001), find that the conduct of an audit benefits all stakeholders associated with the company; the stakeholders are interested in the increased credibility of financial reporting of the company, whether or not they participate in the selection of the auditor.

2.3 Corporate governance

Corporate governance focuses on the management of companies, the control of management and the performance of companies. Spira, (2001), asserts that the key elements of the accountability framework for a company are financial reporting; the presence of non-executive directors and audit quality; efficient boards of directors and the audit are two important elements to the control of companies and all parties benefit to some extent from the conduct of a financial statements audit. According to the Corporate Governance Committee of the Organization for Economic Cooperation and Development, (OECD, 2004), corporate governance is defined as a system by which companies are directed and controlled.

Shleifer and Vishny, (1997), define corporate governance as dealing with the ways in which suppliers of finance to companies assure themselves of getting a return on their investment. This definition refers to the set of mechanisms; the mechanisms include boards of directors, institutional shareholding, auditors, the market and the legal system. In their studies, Denis and McConnell, (2003), and Larcker et al., (2007), assert that the mechanisms influence the decisions made by self-interested managers when there is a separation of ownership and control, to maximize the value of the company to its owners.

2.4 The Capital Markets Act, 2002; Guidelines on Corporate Governance Practices

In May of 2002, the Capital Markets Authority issued Guidelines on Corporate Governance Practices by Public Listed Companies in Kenya, through Gazette Notice No. 3362 (The Capital Markets Act, *Chapter 485A of the Laws of Kenya*). These guidelines were developed taking into account the work which had been undertaken extensively by several jurisdictions through many task forces and committees in different countries including the United Kingdom, Malaysia, South Africa, the Organization for Economic Cooperation and Development (OECD) and the Commonwealth Association for Corporate Governance. The objective of these guidelines was to strengthen corporate governance practices by public listed companies in Kenya and to promote the standards of self-regulation in order to bring the level of governance in line with international trends.

The Capital Markets Authority, in developing these guidelines, adopted both a prescriptive and a non-prescriptive approach in order to provide for flexibility and innovative dynamism to

corporate governance practices by public listed companies. Good corporate governance practices should be nurtured and encouraged to evolve as a matter of best practice. In this regard, the Capital Markets Authority expects the directors of every listed company to undertake or commit themselves to adopt good corporate governance practices as part of their continuing listing obligations.

The Capital Markets Act, *Chapter 485A of the Laws of Kenya, (2002)*, lays down a number of principles that are essential for good corporate governance practices. With regard to boards' of directors characteristics, the following are identified as representing a critical foundation for good corporate governance practices:

- a) *Clause 2.1 requires that every public listed company should be headed by an effective board to offer strategic guidance, lead and control the company and be accountable to its shareholders;*
- b) *Clause 2.1.4 requires that the board should be composed of a balance of executive directors and non-executive directors (including at least one-third independent, non-executive directors) of diverse skills or expertise in order to ensure that no individual or small group of individuals can dominate the board's decision-making processes;*
- c) *Clause 2.1.4.1 defines 'Independent director' as a director who has not been employed by the company in an executive capacity within the last five years; is not associated to an adviser, or consultant to the company, or a member of the company's senior management;*
- d) *Clause 2.1.4.2 defines a 'Non-Executive Director' as a director who is not involved in the administrative or managerial operations of the company;*
- e) *Clause 2.1.6 requires that no person save a corporate director, who is a director of a listed company, shall hold such position in more than five public listed companies at any one time, subject to the requirements under the Capital Markets (Securities) (Public Offers, Listing and Disclosures) Regulations (2002);*
- f) *Clause 3.1.1(ii) defines the role of boards of directors as to oversee the corporate management and operations, management accounts, major capital expenditures and review corporate performance and strategies;*

- g) *Clause 3.1.2 defines a balanced board as one that reflects a balance between independent, non-executive directors and executive directors; the independent and non-executive directors form at least one third of the membership of the board and the structure of the board comprises a number of directors, which fairly reflects the company's shareholding structure. The size of the board should not be too large to undermine an inter-active discussion during board meetings or too small such that the inclusion of wider expertise and skills to improve the effectiveness of the board is compromised;*
- h) *Clause 3.1.3 requires that the board of every public listed company appoint a nominating committee, which consists mainly of independent and non-executive directors, with the responsibility of proposing new nominees for the board, and for assessing the performance and effectiveness of directors in the company. The nominating committee should consider persons of caliber, credibility and who have the necessary skills and expertise to exercise independent judgment on issues that are necessary to promote the company's objectives, and performance in its area of business.*

2.5 Extant research and hypotheses development

Fama and Jensen, (1983), suggest that boards of directors are the highest-level of control mechanism in organizations; they possess the ultimate power to compensate the decisions that are made by top managements. Several characteristics of boards of directors may influence their effectiveness in discharging the monitoring role; they include composition of independent non-executive directors, meeting frequency, expertise and size. These characteristics have been used in prior studies as proxies for effective monitoring of the performance of the management of companies (Carcello et al., 2002).

The role of disclosure in capital markets is crucial; by increasing the amount of information released to the public, companies can lower their capital costs, gain investor confidence and improve the marketability of their shares (Meek et al., 1995).

2.6 Audit fees and corporate governance

Studies by O'Sullivan, (2000), Carcello et al., (2002), and Hay and Knechel, (2004), indicate that audit fees have relationship with the quality of corporate governance. Other studies by Tsui et al.,

(2001) and Muniandy, (2007), suggest that auditors regard corporate governance as an internal control mechanism, which influences the nature and extent of audit testing. In this study, boards' of directors characteristics examined include board independence, board diligence, board expertise and board size.

2.6.1 Audit fees and board independence

Board independence refers to the proportion of non-executive board members over the total board size. Hay and Knechel, (2004), argue that independent board members will be supportive of the external audit function because they seek to reduce their responsibility and liability against questionable financial reporting decisions made by management.

Fama and Jensen, (1983), posit that boards of directors are the best control mechanism to monitor the actions of management; their study focuses on board independence based on agency theory; agency theorists view boards of directors as a potentially effective element of corporate governance. High board independence is assumed to lead to lower audit fees, because high board independence is likely to provide superior oversight on the financial reporting process, resulting in greater reliability and validity in accounting reports (Dechow et al., 1996).

Alternatively, Beasley and Petroni, (2001), argue that boards with a higher percentage of outside directors will seek higher quality audits in order to provide more effective monitoring of corporate management. Studies by O'Sullivan, (2000), and Salleh et al., (2006), find that the proportion of non-executive directors has a significant positive impact on audit fees. They suggest that the presence of non-executive directors encourages audits that are more intensive. In addition, Jensen and Meckling, (1976), highlight that auditing is one method of ensuring that managers will act in the best interest of the outside shareholders.

Similarly, O'Sullivan, (1997), finds that companies with a higher proportion of non-executive directors are more likely to demand more oversight responsibilities as opposed to boards with a lower proportion of non-executives. Greater board independence with financial expertise is related to more transparent disclosures on the performance of companies (Felo and Solieri, 2009), which might require more audit effort than the usual amount of effort being expended, resulting in an increase in audit quality and higher audit fees. For this study, board independence

is measured as the ratio of percentage of outside directors to total directors. Therefore, this study hypothesizes that:

H_{0n} : *There is no relationship between board independence and external audit fees.*

The alternative hypothesis is:

H_{0a} : *There is a positive relationship between board independence and external audit fees.*

2.6.2 Audit fees and board diligence

Boards of directors should be aware of their own strengths and weaknesses; board diligence refers to the number of board meetings that occur during the year. The major impediment that prevents board diligence is lack of time to complete board duties (Lipton and Lorsch, 1992). Studies by Pound, (1995), Conger et al., (1998), and Vafeas, (1999), indicate that an increase in the number of board meetings could increase the aspect of board effectiveness.

The question is whether greater board diligence results in a higher level of oversight of the financial reporting process, which in turn may result in higher audit fees. One way to evaluate whether board members play their roles in representing the shareholders is by observing the activities of the board; the activities of the board would reflect the board's commitment to discharging its role as an agent of the company (Jensen and Meckling, 1976).

Boards that demonstrate greater diligence in discharging their responsibilities, as measured by the number of board meetings, seek closer scrutiny of the financial reporting process (Carcello and Neal, 2000; Conger et al., 1998; Vafeas, 1999). Prior studies that investigate non-financial companies generally find evidence supporting a positive relationship between the number of board meetings and audit fees (Abbott et al., 2003). Diligent boards of directors would be more concerned with the financial reporting aspects of the companies.

Conger et al., (1998), provide support that boards of directors that meet frequently are more likely to discharge their duties well and improve their effectiveness. This indicates that a good system of internal control is working. Boards of directors in companies that have more frequent meetings would allow the board members to discuss identified problems, leading to superior performance of companies (Evans and Weir, 1995); more frequent meetings would enable the

auditors to rely more on the strong internal control of the companies and reduce their workload and fees charged.

Boards of directors that meet frequently are likely to perform their duties attentively and are therefore beneficial to the shareholders (Byrne, 1996); the enhanced oversight may substitute for some of the auditor's effort, and in essence decrease the audit fees. Boards of directors have emerged as both the target of blame for recent corporate misdeeds and as the source capable of improving corporate governance. For this study, board diligence is measured as the number of board meetings that occur during the year. Therefore, this study hypothesizes that:

H_{1n}: There is no relationship between board diligence and external audit fees.

The alternative hypothesis is:

H_{1a}: There is a negative relationship between board diligence and external audit fees.

2.6.3 Audit fees and board expertise

To assure that the monitoring role of the board is discharged effectively, the expertise of the board members is critical. Board expertise refers to directors who sit on multiple boards and have significant investment knowledge in developing reputation capital as decision experts (Fama, 1980; Fama and Jensen, 1983). The number of directorships held by a director in other listed companies proxy for reputation capital (Vafeas, 1999). This is consistent with the existing literature (Beasley 1996; Cotter et al., 1997).

The number of additional directorships could reflect a director's prominent reputation and his/her ability in ensuring effective monitoring of companies (Beasley, 1996). Studies by Carcello et al., (2002), and Ferris et al., (2003), suggest that the members of boards of directors who have more experience in terms of a higher number of directorships are more likely to demand high-quality audit work, which leads to higher audit fees.

On the other hand, it can be argued that multiple directorships show enhanced quality of oversight by the board. This enhanced oversight may substitute increased auditor effort and reduce the auditor's assessment of control risk, resulting in decreased audit fees. Pfeffer and Salancik, (1978), and Boyd, (1990), present an alternative to the agency perspective. They contend that good corporate governance is achieved when board members are appointed for their expertise to help companies cope successfully with environmental uncertainty.

Daily et al., (2003), suggest that over-emphasis on directors' oversight role to the exclusion of alternative roles such as resource, service and strategy roles is one potential explanation of limited evidence from board oversight functions. To perform specified duties and responsibilities, the board members must consist of a diverse collection of skills and competencies (Reilly, 2003). In addition, having board members who lack knowledge and experience actually threatens the company's overall performance due to their inability to deal with issues affecting the company's business. In this study, board expertise is measured as the average number of directorships held in other listed companies by non-management directors. Therefore, this study hypothesizes that:

H_{2n}: There is no relationship between board expertise and external audit fees.

The alternative hypothesis is:

H_{2a}: There is a positive relationship between board expertise and external audit fees.

2.6.4 Audit fees and board size

The long-term objectives and direction of organizations are the responsibility of boards of directors. A study by Beasley, (1996), finds that the size of the boards of directors has material impact on the quality of corporate governance and significantly affects the likelihood of financial statement frauds; as the board size increases, the likelihood of financial statement frauds also increases.

Lipton and Lorsch, (1992), argue that large boards are less effective and easier for the CEO to control. Bushman et al., (2004), show that smaller boards have the advantage of lower coordination costs and less free riding among board members, and in this respect support the idea that large boards can be dysfunctional. Board size is likely to affect the financial reporting process, hence the audit process. Anderson et al., (2004), posit that larger boards devote more resources to oversee the internal control systems, thus enhancing board performance. In addition, large boards may have multi-skilled, knowledgeable and experienced members as opposed to smaller boards (Jensen, 1993; Vefeeas, 1999).

With regard to audit quality studies, Abbott et al., (2004), suggest that companies with smaller board sizes experience lower incidence of restatements, as the smaller boards contribute to

effective communication and there is less likelihood of communication breakdowns. This suggests that when board members communicate effectively, they reduce the incidences of misunderstandings and consequent errors, and that they are more sensitive to the issues that may affect their shareholders' confidence, particularly concerning financial reporting issues. For this study, board size is measured as the total number of directors on the board. Therefore, this study hypothesizes that:

H_{3n}: There is no relationship between the board's size and external audit fees.

The alternative hypothesis is:

H_{3a}: There is a positive relationship between the board's size and external audit fees.

2.7 Control variables related to audit fees

Studies by Zahra and Pearce, (1989), and Hillman and Dalziel, (2003), depict that monitoring and providing resources are the two main functions of boards of directors. Yet Carcello et al., (2002), argue that boards of directors seek to protect their reputation capital, to avoid legal liability and to promote shareholder interests by purchasing differentially higher audit quality, through higher audit fees. Studies by Simunic, (1980), and Craswell et al., (1995), suggest that audit fees are associated with company characteristics of company size, financial risk, and complexity. These company characteristics are included as control variables in this study; the control variables in the audit fees regression model are intended to control for cross-sectional differences in factors that affect audit fees.

2.7.1 Company size

The size of a company is measured in terms of assets. Since the pioneering study of Simunic, (1980), on determinants of audit fees, as well as in other studies (such as Simon and Francis, 1988; Craswell et al., 1995; Carcello et al., 2002), company size appears to be the central explanatory feature when studying the magnitude of audit fees. Studies by Simunic, (1980), Francis and Stokes, (1986), Palmrose, (1986), and Francis and Simon, (1987), suggest that the most dominant determinant of audit fees is company size; as company size can influence the scope and complexity of the audit, a positive relationship between company size and audit fees is expected.

Carson and Fargher, (2007), consider that audit fees are different depending on the market segment in which the auditor competes, where market segment is based on company size. Chan et al., (1993), propose that the relationship between company size and audit fees is unlikely to be linear because there might be economies of scale in the auditor's production function. Studies by Taylor and Baker, (1981), Firth, (1985), Simon et al., (1992), Chan et al., (1993), Anderson and Zeghal, (1994), Collier and Gregory, (1996), Firth, (1997), Langendjik, (1997), and Clatworthy and Peel, (2006), confirm that company size is an important factor which is associated with the audit fees charged. This study uses total assets (gross) as a measure of company size.

2.7.2 Financial risk

The capital ratio, measured by dividing equity by total assets, reveals capital adequacy and should capture the general safety and soundness of the company. It indicates the ability of a company to absorb losses and handle risk exposure with shareholders. Equity to total asset ratio is expected to have a positive relation with company performance; well-capitalized companies are less risky and more profitable (Bourke, 1989). Companies that have low equity-to-total assets ratio are characterized by greater financial risks (Defond and Jiambalvo, 1994); they will bring greater litigation risk to auditors (Heninger, 2001).

A study by Sun and Liu, (2011), suggests that clients' high risk can force auditors to perform more effectively; therefore, financial reporting risk should be incorporated in audit procedures and audit testing to identify 'red flags' signals that lead to possibilities of fraudulent activity. A risky company is expected to run the risk of audit failure; this would require an intensive audit testing and thus an increase in audit fees (Simunic, 1980). The study by Johnstone and Bedard, (2001), indicates that after controlling for the planned audit hours, the client's fraud and error risk factors significantly affect the auditor's proposed fees for an engagement. This suggests the existence of a price premium for client risk. Bonner et al., (1998), find fictitious transactions to be the most common type of financial reporting frauds litigation cases on auditors.

Hay and Knechel, (2004), argue that the demand for auditing is a function of the set of risks faced by the individual stakeholders in a company and the set of control mechanisms available for mitigating those risks. Firth, (1993), finds that higher client risks increase auditor effort,

resulting in higher audit fees; the accounting firm will have to undertake detailed work to resolve or moderate the risk. In this study, financial risk is computed by dividing equity by total assets.

2.7.3 Complexity

The complexity variable has been used widely in many prior studies on audit fees models (Simunic, 1980; Chan et al., 1993; O’Keefe et al., 1994; Joshi and Al-Bastaki, 2000; Cameran, 2005; Clatworthy and Peel, 2006). Literature documents the business complexity of the company being audited as a determinant of audit fees. A company that is more complex requires deeper and more comprehensive audit tests before the auditor can provide an objective opinion; indeed the auditor needs to put more effort in planning, coordinating and executing the audit function as the complexity increases. Companies that have complex businesses require more time and this would result in higher audit fees.

Complexity also depends on whether a company is centralized or decentralized; a decentralized company implies a higher audit risk and requires greater monitoring and coordination effort for the many decision units (Simunic, 1980; Palmrose, 1986). Miltz et al., (1991), show that more audit input is required to look at and verify the different transactions and processes of a decentralized company.

Studies by Palmrose, (1989), Davis et al., (1993), O’Keefe et al., (1994), and Davidson and Gist, (1996), show significant and positive relationship between the level of a company’s operational complexity and audit hours. Inventory and receivables constitute a high audit risk category whose evaluation is complex and requires more in-depth inspection, that is, physical observation and circularization; as well as a relatively stronger involvement on the part of the external auditors (Simunic, 1980). Studies by Cobbin, (2002), and Hay and Knechel, (2004), show that the complexity variable turns out to be useful in illustrating how audit fees are determined. In this study, the inventory and receivables intensiveness is measured by the summation of inventory and accounts receivable by total assets.

2.7.4 Company leverage

Company leverage (debt) is used to control for audit risk. Francis, (1984), finds that a high leverage is associated with high audit risk; its coefficient is expected to be negative. In this study,

company leverage is computed by dividing short-term debt and long-term debt by total assets.

2.8 Conceptual framework (dependent variable - audit fees)

The conceptual framework for this study is drawn from research carried out previously. The dependent variable for the conceptual model in figure 2.1 is audit fees. Figure 2.1 conceptualizes that audit fees can be explained by the following independent variables: board independence, board diligence, board expertise, and board size. The control variables act as moderators.

Independent variables

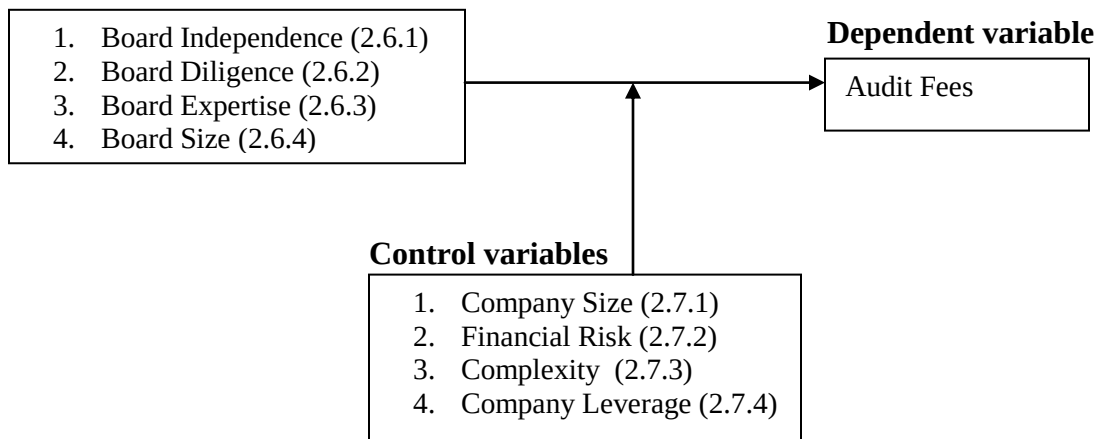


Figure 2.1: The conceptual model for audit fees as the dependent variable

2.8.1 Operationalization of variables – audit fees and boards’ of directors characteristics

This study operationalizes corporate governance using boards’ of directors characteristics in identifying the variables that influence the relationship between corporate governance and audit fees for listed companies on the Nairobi Securities Exchange. The boards’ of directors characteristics studied in this research are board independence, board diligence, board expertise and board size. The variables presented in Tables 2.1 and 2.2 are used to test the hypotheses in the study.

Table 2.1: Dependent and independent variables

Variable	Formula	Rationale	Source
Dependent variables			
Audit Fees	Natural logarithm of audit fees	Used as a measure of external monitoring cost to the company.	Anderson et al., (1993); Craswell et al., (1995); Francis and Stokes, (1986); Gul and Tsui, (1998); Simunic, (1980); Simunic and Stein, (1987).
Independent variables			
Board Independence (BODI)	Proportion of outside directors to total directors on the board	Used as a monitoring role in diffuse ownership and as a mechanism to discipline managers. High board of directors' independence lowers external audit fees as they are more likely to provide superior oversight on the financial reporting process; this results in greater reliability and validity in the accounting reports.	Abbott et al., 2003); Beasley, (1996); Beasley and Petroni, (2001); Carcello et al., (2002); Dechow et al., (1996); Fama, (1980); Fama and Jensen, (1983); Hay and Knechel, (2004); O'Sullivan, (1997); O'Sullivan, (2000); Weir and Laing, (2003).
Board Diligence (BODD)	Number of board meetings that occurred during the year	Used as a measure of board monitoring process. More board meetings held imply that the directors are likely to contribute more and be more effective to oversight matters concerning the financial reporting process. Effectiveness is construed from the functional forms, for example, audit quality and internal control.	Conger et al., (1998); Byrne, (1996); Lipton and Lorsch, (1992); Pound, (1995); Vafeas, (1999).
Board Expertise (BODE)	Average number of outside directorships held in other listed companies by non-management directors	Used as a measure of investment knowledge and enhanced quality of oversight by board members as decision experts.	Boyd, (1990); Beasley, (1996); Bedard et al., (2004); Cotter et al., (1997); Fama, (1980); Fama and Jensen, (1983); Ferris et al., 2003); Reilly, 2003); Pfeffer and Salancik, (1978).
Board Size (BODS)	Total number of directors on board	Used as a measure of the company's internal control mechanism enhancement. Larger boards are less effective in monitoring the financial reporting process; the external auditor considers the control mechanism weak.	Anderson et al., (2004); Beasley, (1996); Bushman et al., (2004); Jensen, (1993); Vafeas, (1999); Vafeas, (2000); Yermack, (1996).

Table 2.2: Control variables related to audit fees

Control variables	Formula	Rationale	Source
Company Size (LNTA)	Natural logarithm of total assets (gross)	Used as a control for the size of the company.	Taylor and Baker, (1981); Firth, (1985); Simon et al., (1992); Chan et al., (1993); Collier and Gregory, (1996); Firth, 1997; Langendjik, (1997); Clatworthy and Peel, (2006).
Financial Risk (FR)	Equity/total assets ratio	Used as a measure of the financial health of the company.	Firth, (1993); Defond and Jiambalvo, 1994; Heninger, 2001; Johnstone and Bedard, (2001).
Complexity (INVRECTA)	Ratio of (inventory and receivables) to total assets	Used as a control to indicate the depth and extent of audit input.	Cameran, (2005); Chan et al., (1993); Clatworthy and Peel, (2006); Cobbin, (2002); Davidson and Gist, (1996); Davis et al., (1993); Miltz et al., (1991); Palmrose, (1986); Simunic, (1980); O'Keefe et al., (1994); Joshi and Al-Bastaki, (2000).
Company Leverage (LEV)	Ratio of (short term loans + long term loans)/total assets	Used as a control for audit risk and the company's use of debt.	Francis, (1984).

Consistent with previous studies (Goodwin-Stewart and Kent, 2006; Abbott et al., 2003; Carcello et al., 2002), this study uses the pooled ordinary least squares (POLS) regression model to examine the relationship between the explanatory variables and audit fees.

2.8.2 Model specification: audit fees and corporate governance

To test the hypotheses in sections 2.6.1 to 2.6.4, the pooled ordinary least squares (POLS) regression is used to examine the effect of boards' of directors characteristics on audit fees. The choice of the model is appropriate and is similar to cross-sectional audit fees regression model specified in audit fees studies by Simunic, (1980), Francis, (1984), Maher, et al., (1992) and Craswell et al., (1995).

Model 1

$$LNFE_{it} = f(LNTA_{it}, INVRECTA_{it}, FR_{it}, LEV_{it}, BODI_{it}, BODD_{it}, BODE_{it}, BODS_{it}) \text{ (Equation 2.1)}$$

The audit fees model

The general form of the pooled ordinary least squares regression model is as follows:

$$LNFEF_{it} = \alpha_0 + \sum_{m=1}^8 \beta_m CG_{it} + \varepsilon_{it} \quad (\text{Equation 2.2})$$

Where,

$LNFEF_{it}$ = the natural log of audit fees for company i at time t ; $i = 1, 2, 3 \dots, 30$ companies;

α_0 = measures the intercept;

β_m = the coefficients of CG_{it} variables;

CG_{it} = the different independent and control variables for corporate governance mechanism of company i at time t ;

t = the time period where $t = 1, 2 \dots, 7$ years; and

ε_{it} = measures the error term.

When converted into the specified variables, the general pooled ordinary least squares (POLS) model becomes:

$$LNFEF_{it} = \alpha_0 + \beta_1 LNTA_{it} + \beta_2 INVRECTA_{it} + \beta_3 FR_{it} + \beta_4 LEV_{it} + \beta_5 BODI_{it} + \beta_6 BODD_{it} + \beta_7 BODE_{it} + \beta_8 BODS_{it} + \varepsilon_{it} \quad (\text{Equation 2.3})$$

Explanation of abbreviations of variables used in the models is:

α_0 = constant term;

β_m = the coefficients of corporate governance and control variables;

$LNFEF_{it}$ = natural log of audit fees for company i at time t ; $i = 1, 2, 3 \dots, 30$ companies;

$LNTA_{it}$ = natural log of total assets for company i at time t ; $i = 1, 2, 3 \dots, 30$ companies;

$INVRECTA_{it}$ = (inventory and receivables) divided by total assets for company i at time t ; $i = 1, 2, 3 \dots, 30$ companies;

FR_{it} = equity divided by total assets for company i at time t ; $i = 1, 2, 3 \dots, 30$ companies;

LEV_{it} = (short-term debt and long-term debt) divided by total assets for company i at time t ; $i = 1, 2, 3 \dots, 30$ companies;

$BODI_{it}$ = proportion of independent non-executive directors sitting on the board for company i at time t ; $i = 1, 2, 3 \dots, 30$ companies;

$BODD_{it}$ = number of board meetings held during the financial year for company i at time t : $i = 1, 2, 3 \dots, 30$ companies;

$BODE_{it}$ = the average number of outside directorships held in other listed companies by non-management, directors for company i at time t : $i = 1, 2, 3 \dots, 30$ companies;

$BODS_{it}$ = number of directors on the board of company i at time t : $i = 1, 2, 3 \dots, 30$ companies;
and

ε_{it} = standard error of estimation (represents the unexplained variation).

The above model is made up of three types of variables: the dependent variable, the hypothesized variables and the control variables. The dependent variable is audit fees, which in the model is coded as the natural log of audit fees, to improve the linear fit of the data. This is consistent with studies done on audit fees, for example, Craswell et al., (1995), Carcello et al., (2002), and Hay and Knechel, (2004). The use of the natural log reduces the heteroskedasticity and provides a better fit for outliers within the distribution.

2.9 Corporate governance disclosure

Studies have investigated various determinants of companies' disclosure practices. The consistent finding is that size is an important predictor of company reporting behaviour (Ahmed and Courtis, 1999). Industry type is another company attribute associated with corporate disclosure (Cooke, 1989; 1992). In their study, Chen and Jaggi, (2000), observe a positive relationship between the proportion of non-independent executive directors and comprehensiveness of financial disclosures.

There are several different approaches that have been adopted to measure disclosure quality (Cerf, 1961). Disclosure is an abstract construct that does not possess inherent characteristics by which one can determine its intensity or quality (Wallace and Naser, 1995). To test for effectiveness of boards of directors in ensuring compliance with the corporate governance disclosure requirements, it is necessary for a corporate governance disclosure index to be constructed. A corporate governance disclosure index (CGDI) is calculated by assigning a weight of 1 for each item of disclosure chosen if it exists or 0 if it does not exist. Indices are then derived by computing the ratio of actual scores awarded to the maximum possible score

attainable for items that are applicable to each company. The following formula is used to compute the corporate governance disclosure index:

$$\text{CGDI} = \frac{\text{Total score of the individual company} \times 100}{\text{Maximum possible score obtainable by company}}$$

An analysis is then carried out to find the extend of compliance with the disclosure requirements by the listed companies. Several characteristics of boards may influence the effectiveness in their monitoring role. The characteristics include independence, meeting frequency, expertise and size.

2.9.1 Corporate governance disclosure and board independence

Boards of directors are central to the corporate governance systems of listed companies because of the fiduciary duty they have towards shareholders (Dalton et al., 1998). Chen and Jaggi, (2000), argue that outsider dominated boards should be more concerned with investors' demands for informative disclosure and should enhance the comprehensiveness of company disclosure; they report a positive association between board independence and the comprehensiveness of financial disclosures.

Cheng and Courtenay, (2006), examine the association between board monitoring and the level of disclosure and find that companies with a higher proportion of independent directors on the board have higher levels of disclosure. The presence of outside directors who are less aligned to management, encourages companies to disclose more information to outside investors; this would result in better monitoring of the activities of the boards and limit managerial opportunism (Fama, 1980; Fama and Jensen, 1983; Weir and Laing, 2003; Chau and Leung, 2006). Therefore, our hypothesis is as follows:

H_{4n}: There is no relationship between board independence and the level of corporate governance disclosures.

The alternative hypothesis is:

H_{4a}: There is a positive relationship between board independence and the level of corporate governance disclosures.

2.9.2 Corporate governance disclosure and board diligence

As boards of directors hold more meetings, the more enhanced they will be at monitoring management; this will result in a strong control role (Evans and Weir, 1995). The length of the meetings can be considered effective at enhancing the control environment since one meeting of two hours and two meetings of one hour give boards of directors the same amount of time to monitor management. However, the enhanced monitoring by boards of directors can ensure that management fulfils the shareholders' interests and not act in self-interested ways. Therefore, the hypothesis is:

H_{5n}: There is no relationship between board diligence and the level of corporate governance disclosures.

The alternative hypothesis is:

H_{5a}: There is a positive relationship between board diligence and the level of corporate governance disclosures.

2.9.3 Corporate governance disclosure and board expertise

The number of directorships held by a director in other listed companies proxy for reputation capital (Vafeas, 1999); the number of additional directorships could reflect a director's prominent reputation and the ability in ensuring effective monitoring of companies (Beasley, 1996). Pfeffer and Salancik, (1978), and Boyd, (1990), present an alternative to the agency perspective; they contend that good corporate governance is achieved when board members are appointed for their expertise to help companies cope successfully with environmental uncertainty. Therefore, the hypothesis is:

H_{6n}: There is no relationship between board expertise and the level of corporate governance disclosures.

The alternative hypothesis is:

H_{6a}: There is a negative relationship between board expertise and the level of corporate governance disclosures.

2.9.4 Corporate governance disclosure and board size

Studies by Jensen, (1993), and Yermack, (1996), argue that boards of directors are less effective monitors as they grow in size; this is because control over management will be reduced.

According to Vaefas, (2000), small boards of directors will more likely take responsibility for monitoring companies' operations than large boards of directors. Large boards of directors may be slower to react to decisions that require immediate courses of action. Furthermore, as the number of directors is increased, boards of directors lose the ability to be direct and decisive in their operations. Jensen, (1993), finds that the directors become less candid in the ability to be critical of one another, which results in less efficient decision-making. Therefore, the hypothesis is:

H_{7n}: There is a negative relationship between board size and the level of corporate governance disclosures.

The alternative hypothesis is:

H_{7a}: There is a positive relationship or no relationship between board size and the level of corporate governance disclosures.

2.10 Control variables related to corporate governance disclosure

To test the hypothesis, control variables drawn from a review of prior corporate governance literature are included in the model. The control variables are company size, company leverage and industry type (Ahmed and Nicholls, 1994).

2.10.1 Company size

Disclosure studies carried out find the size of company to be an important factor in explaining disclosures (Hossain et al., 1995). Large companies have higher agency costs; a positive association between size and the level of corporate disclosure is predicted (Jensen and Meckling, 1976). Prior research suggests that company size is a key determinant of the extent of voluntary disclosure (Chow and Wong-Boren, 1987; Lang and Lundholm, 1993; Ahmed and Courtis, 1999; Eng and Mak, 2003). Large companies are expected to disclose more information. Company size is measured as the natural logarithm of total assets.

2.10.2 Company leverage

Revealing information would reduce information asymmetry between the company and debt holders; this in return would reduce the cost of capital (Firth, 1979; Botosan, 1997). Ahmed and Courtis, (1999), show that company leverage is positively related to company disclosure level. However, studies by Eng and Mak, (2003), document a negative association between a

company's debt ratio and the extent of voluntary disclosure. Information disclosure contributes to solve monitoring problems between stockholders and creditors, resulting in expected positive relationship between leverage and the level of disclosure (Raffournier, 1995). Company leverage is measured by dividing short-term debt and long-term debt by total assets.

2.10.3 Industry type

Some industries disclose more information than others (Cooke, 1991); a company with high level of disclosure could be dominant in the industry and this could have an effect on the disclosure levels of other companies in the same industry. Companies in a specific industry may face particular circumstances that may influence their disclosure practice (Wallace et al., 1994). Other studies find insignificant relationship between industry type and information disclosure (Chau and Gray, 2002).

2.11 Conceptual framework (dependent variable - corporate governance disclosure)

The conceptual framework for this study is drawn from research carried out previously. The dependent variable for the conceptual model in figure 2.2 is the corporate governance disclosure index. Figure 2.2 conceptualizes that corporate governance disclosure can be explained by the following independent variables: board independence, board diligence, board expertise, and board size. The control variables act as moderators.

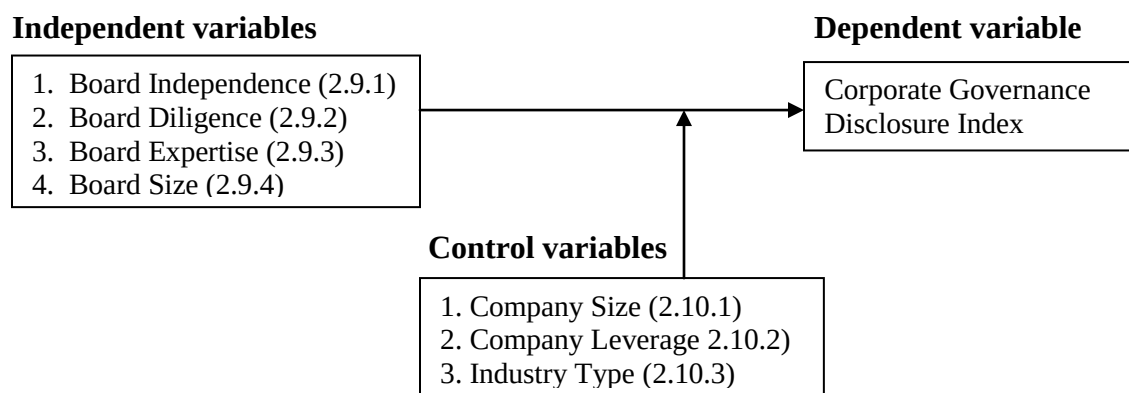


Figure 2.2: The conceptual model for corporate governance disclosure as the dependent variable

Previous studies have examined the association between corporate governance attributes and the level of corporate governance disclosure (Forker, 1992; Chen and Jaggi, 2000; Ho and Wong,

2001). Different companies influence the level of corporate governance disclosure; the corporate governance disclosure index is the dependent variable and boards' of directors characteristics the independent variables.

2.11.1 Operationalization of variables – corporate governance disclosure and boards' of directors characteristics

This study operationalizes corporate governance disclosure using boards' of directors characteristics to examine the adequacy of corporate governance disclosure by listed companies in Kenya. In addition, boards' of directors characteristics are used to find out the relationship between boards' of directors characteristics and the level of corporate governance disclosure compliance by listed companies in the Kenyan securities market.

A number of researchers have used weights for the different items in the disclosure lists; weights are allocated to the corporate governance disclosure items based on their relative importance according to financial analysts (Cerf, 1961; Buzby, 1975; Firth, 1979). A study by Buzby, (1975), argues that companies have limited amounts of money that can be spent in providing information.

Many researchers have used an un-weighted index (Cooke, 1989; Owusu-Ansah, 1998; Haniffa and Cooke, 2002). A dichotomous method of scoring is used; 1 if an item is disclosed or 0 if the item is not disclosed. In order to arrive at an idea of the degree of compliance of any particular annual, an un-weighted approach would be preferable. This study adopts the un-weighted method to measure compliance with the corporate governance disclosure.

There are many corporate governance disclosure requirements, but in this study, ten of those corporate governance disclosure requirements are studied. The ten characteristics are allocated indices and a scoring system where each index represents 1 point, which add up to 10 as shown in Table 2.3. This makes it possible to express the degree of compliance for the various company years as percentages.

Table 2.3: Summary of corporate governance disclosure aspects used in the study

No.	Corporate governance disclosure item	Weight
1.	Has the listed company disclosed in a statement of the directors whether the company complies with the guidelines on corporate governance in its annual report? ~ Clause 1.8	1
2.	Has the board established relevant committees and delegated specific mandates to the committees as may be necessary? ~ Clause 2.1.1 (i)	1
3.	Is the board composed of a balance of executive/Non-executive/Independent directors of diverse skills or expertise in order to ensure that no individual or small groups of individuals dominate the boards' decision-making process? ~ Clause 2.1.4	1
4.	Is there a clear separation of the role and responsibilities of the chairperson and the chief executive officer, in order to ensure a balance of power of authority to provide checks and balances? ~ Clause 2.2.1	1
5.	Has the board ensured that the accounts are presented in line with International Financial Reporting Standards? ~ Clause 2.4.1	1
6.	Has the consolidated total remuneration of the directors been disclosed in the annual report? ~ Clause 3.1.4 (iv)	1
7.	Has the company communicated relevant information on its performance (via distribution of annual reports, release of notices to the NSE in form of half-yearly and annual reports) as a matter of best practice? ~ Clause 3.3 (ii)	1
8.	Does an established audit committee of independent and non-executive directors exist? ~ Clause 3.5.1	1
9.	Has the board established an internal audit function? ~ Clause 3.5.4	1
10.	Does the company disclose the top ten major shareholders in the annual report and financial statements? ~ Clause 2.1.3 (ii) (b)	1
	Total	10

Source: The Capital Markets Act, *Chapter 485A*, 2002, Gazette Notice No. 3362

The variables discussed in tables 2.4 and 2.5 are used to test the corporate governance disclosure hypotheses developed for the study.

Table 2.4: Dependent and independent variables

Variable	Formula	Rationale	Source
Dependent variable			
Corporate Governance Disclosure Index (CGDI)	Percentage of overall applicable corporate governance disclosure index	Used as a measure of the effectiveness of board of directors in ensuring compliance with the corporate governance disclosure requirements.	International Research Journal of Finance and Economics, ISSN 1450-2887 Issue 57 (2010). http://www.eurojournals.com/finance.htm . Last accessed on 18/7/2011.
Independent variables			
Board Independence (BODI)	Proportion of outside directors to total directors on the board	Used as a monitoring role in diffuse ownership and as a mechanism to discipline managers. High board of directors' independence lowers external audit fees as they are more likely to provide superior oversight on the financial reporting process; this results in greater reliability and validity in the accounting reports.	Dalton et al., (1998); Chen and Jaggi, (2000); Weir and Laing, (2003); Cheng and Courtenay, (2006); Chau and Leung, (2006).
Board Diligence (BODD)	Number of board meetings that occurred during the year	Used as a measure of board monitoring process. More board meetings held imply that the directors are likely to contribute more and be more effective to oversight matters concerning the financial reporting process.	Evans and Weir, (1995).
Board Expertise (BODE)	Average number of directorships held in other listed companies by non-management directors	Used as a measure of investment knowledge and enhanced quality of oversight by board members as decision experts.	Beasley, (1996); Boyd, (1990); Pfeffer and Salancik, (1978).
Board Size (BODS)	Total number of directors on board	Used as a measure of the company's internal control mechanism enhancement. Larger boards are less effective in monitoring the financial reporting process; the external auditor considers the control mechanism weak.	Jensen, (1993); Vaefas, (2000); Yermack, (1996).

Table 2.5: Control variables related to corporate governance disclosure

Control variables	Formula	Rationale	Source
Company Size (LNTA)	Natural logarithm of total assets (gross)	Used as a control for the size of the company.	Ahmed and Courtis, (1999); Eng and Mak, (2003); Chow and Wong-Boren, (1987); Hossain et al., (1995); Jensen and Meckling, (1976); Lang and Lundholm, (1993).
Company Leverage (LEV)	Ratio of (Short term loans + Long term loans)/Total assets	Used as a control for audit risk and the company's use of debt.	Ahmed and Courtis, (1999); Botosan, (1997); Eng and Mak, (2003); Firth, (1979); Francis, (1984).
Industry Type (IT)	Agricultural: 1- Agricultural company; 0- otherwise	Used due to the fact that significant industry effects exist on a company's investment sector.	Companies annual reports.
	Commercial and services: 1- Commercial and services company; 0- otherwise		
	Industrial and allied: 1- Industrial and allied company; 0- otherwise		
	Alternative investment market segment: 1- Alternative investment market segment company; 0- otherwise		

2.11.2 Model specification: corporate governance disclosure and boards' of directors characteristics

To test the hypotheses in sections 2.9.1 to 2.9.4, the pooled ordinary least squares (POLS) regression is used to find out the relationship between boards' of directors characteristics and the level of corporate governance disclosure compliance by listed companies in Kenya. The level of any kind of disclosure is influenced by different corporate characteristics; therefore, the corporate governance disclosure index will be the dependent variable and boards' of directors characteristics the independent variables.

Model 2

$$CGDI_{it} = f(LNTA_{it}, LEV_{it}, IT1_{it}, IT2_{it}, IT3_{it}, IT4_{it}, BODI_{it}, BODD_{it}, BODE_{it}, BODS_{it})$$

(Equation 2.4)

The corporate governance disclosure model

The general form of the pooled ordinary least squares regression model for corporate governance disclosure index is as follows:

$$CGDI_{it} = \alpha_0 + \sum_{m=1}^{10} \beta_m CG_{it} + \varepsilon_{it} \quad (\text{Equation 2.5})$$

When converted into the specified variables, the general pooled ordinary least squares (POLS) model becomes:

$$CGDI_{it} = \alpha_0 + \beta_1 LNTA_{it} + \beta_2 LEV_{it} + \beta_3 IT1_{it} + \beta_4 IT2_{it} + \beta_5 IT3_{it} + \beta_6 IT4_{it} + \beta_7 BODI_{it} + \beta_8 BODD_{it} + \beta_9 BODE_{it} + \beta_{10} BODS_{it} + \varepsilon_{it} \quad (\text{Equation 2.6})$$

Where,

$CGDI_{it}$ = corporate governance disclosure index for company i at time t ; $i = 1, 2, 3, \dots, 30$ companies;

α_0 = constant term;

β_m = the coefficients of corporate governance and control variables and the other abbreviations are as explained in equation 2.3. The corporate governance disclosure index ($CGDI_{it}$), is the dependent variable in equation 2.6;

$IT1_{it}$ = company in the agricultural industry for company i at time t ; $i = 1, 2, 3, \dots, 30$ companies;

$IT2_{it}$ = company in the commercial and services industry for company i at time t ; $i = 1, 2, 3, \dots, 30$ companies;

$IT3_{it}$ = company in the industrial and allied industry for company i at time t ; $i = 1, 2, 3, \dots, 30$ companies; and

$IT4_{it}$ = company in the alternative investment market segment industry for company i at time t ; $i = 1, 2, 3, \dots, 30$ companies.

2.12 Chapter summary

Chapter 2 presents the literature review on studies carried out on the relationship between boards' of directors characteristics and audit fees. In addition, this chapter presents a literature review on the level of corporate governance disclosures and its association with boards' of directors characteristics. The chapter also presents both the theoretical and conceptual

frameworks adopted in this study. Models specification and related control variables are also presented. Studies done on the relationship between boards' of directors characteristics and audit fees and corporate governance disclosure aspects have been carried out in developed countries and some emerging markets.

This study lays special emphasis on the relationship between boards' of directors characteristics and audit fees, the adequacy of corporate governance disclosure level by listed companies and the relationship between boards' of directors characteristics and the level of corporate governance disclosure compliance by listed companies in Kenya. This study uses data collected to determine the nature of the relationship that exists between the variables.

CHAPTER 3

RESEARCH METHODOLOGY

3.1 Introduction

This chapter presents the methodology used to test the hypotheses outlined in Chapter 2. This study examines the relationship between the boards' of directors characteristics and audit fees. Saunders et al., (2007), states that studies that establish relationships between variables may be termed explanatory studies; this study is therefore an explanatory one. In addition, this study also explores the adequacy of corporate governance disclosure by listed companies in Kenya and the out the relationship between boards' of directors characteristics and the level of corporate governance disclosure compliance by listed companies on the Nairobi Securities Exchange.

A description of the different measures of boards' of directors characteristics and the hypothesized relation with audit fees is undertaken. It also describes the measures used to examine whether corporate governance disclosure by listed companies is adequate and the relationship between boards' of directors characteristics and the level of corporate governance disclosure compliance by listed companies on the Nairobi Securities Exchange. In addressing the concerns enumerated in the study objectives, the study adopts a deductive research approach and quantitative research strategy relying on the secondary data collected.

3.2 Research design

This study requires an examination of panel data for a period of seven years representing the post-adoption period of the issuance of the guidelines on corporate governance practices by listed companies in Kenya. The panel data methodology is adopted because it combines time and cross-sectional or group data. In this study, the group is the selected listed companies and the time is the duration of the data collected, which is the seven-year period from 2003 to 2009.

Examining panel data for this study requires a cross-sectional analysis to find out the relationships that exist amongst the variables under study over the given time period. This study employs quantitative analysis in finding out the relationship between the boards' of directors characteristics and audit fees, the adequacy of corporate governance disclosure by the listed companies and the relationship between boards' of directors characteristics and the level of

corporate governance disclosure compliance by listed companies on the Nairobi Securities Exchange.

3.3 Data set and sample

The data used in this study has been obtained from the Capital Markets Authority library, the internet and web sites of the companies under study. Data for this sample, that is, boards' of directors characteristics, audit fees, corporate governance and financial reporting disclosures are obtained from the financial statements for a selected sample of Kenyan companies listed on Nairobi Securities Exchange (NSE) for a period of seven years. Companies listed at the Nairobi Securities Exchange are required to follow the corporate governance principles issued by the Capital Markets Authority (CMA) in 2002, under the Capital Markets Act (*Chapter 485A of the Laws of Kenya, 2002*).

The sample of interest in this study covers 38 non-financial companies out of the population of 53 companies listed on the Nairobi Securities Exchange at the time the study was done. There were 30 companies in the final sample, as shown in Table 3.1.

Table 3.1: Number of companies studied

Number of companies as stated in NSE Handbook 2009 Edition (p.162)	<u>53</u>
Number of non-financial listed companies	38
Number of companies listed after 2003	(4)
Number of companies whose annual reports were not available for data collection	(4)
Number of companies studied	<u>30</u>

The sample is considered appropriate because financial and insurance companies excluded from this research have extra regulatory environments and the treatment of items in their financial statements is different, making the determination of audit fees different from the non-financial companies. In addition, a number of researchers examining voluntary disclosure exclude financial and insurance companies because they are more highly regulated or because their operations are highly specialized (McNally et al., 1982; Hossain et al., 1995; Meek et al., 1995).

3.4 Data sources and collection methods

This study uses secondary data as the source of information for analysis; information is extracted from the relevant financial statements in the annual reports. Audit fees and the control variables relating to the balance sheet information and complexity of operations are collected from annual reports and financial statements, for a period of seven years (2003 to 2009), representing the post-adoption period of the issuance of the guidelines on corporate governance practices by listed companies in Kenya. In this study, data on corporate governance disclosure requirements is collected from the annual reports and financial statements for the years covering the study period.

3.5 Data analysis procedures

To analyze the data, the statistical software SPSS is used. The data analyzes include descriptive statistics, univariate analysis and multivariate analysis.

3.5.1 Descriptive statistics

Descriptive statistics describes the sample data in an organized form. It includes the mean and standard deviation.

3.5.2 Univariate analysis

Correlation analysis is used as a preliminary test to measure the relationship between the variables and their strength of the association (Pallant, 2001). Correlation coefficients (the Pearson product-moment correlation) provide a numerical summary of the strength and direction of the linear relationship between two variables. The relationship between variables can be inspected visually by generating a scatter plot. The correlation coefficient (the Pearson r) provides an indication of the linear relationship between variables.

3.5.3 Multivariate analysis

The pooled ordinary least squares (POLS) regression model is used as the method of data analysis. Regression is the most suitable tool for use in studying relations between variables (Johnson and Kuby, 2007). The pooled ordinary least squares (POLS) regression is preferred due to three reasons: first, the majority of panel data studies have used this method (Barako, 2007; Javaid et al., 2011; Gul et al., 2011). Secondly, the approach helps in explaining the relationships

among the various variables of the study. Thirdly, the pooled regression model brings out the differences that exist between companies, hence making it superior for the analysis required in this study.

Since the data are bound to be heterogeneous, the panel data technique could take such heterogeneity explicitly into account by allowing individual specific variables. Panel data provide more informative data variability and efficiency. The hypotheses developed in chapter 2 are tested using the pooled ordinary least-squares regression model. The model is similar to the cross-sectional audit fees regression model used by Simunic, (1980), and Craswell et al., (1995).

Before conducting the regression analysis, the assumptions of the ordinary least squares regression model are examined to determine the validity of the model (Chen et al., 2003; Gujarati, 2003 and Hair et al., 2010). There are several outliers in the sample but they are not removed, as they do not distort the assumptions of the regression analysis. The assumptions, which relate to quantitative data analysis, are:

- a) the variables are normally distributed;
- b) there is a linear relationship between the independent variables and the dependent variable;
- c) the variables are measured without error (reliably);
- d) the assumption of homoscedasticity, meaning that the variance of errors is the same across all levels of the independent variables; and
- e) the errors of prediction are distributed normally.

3.5.4 Test for the validity of the model

The purpose of the additional tests is to give reasonable assurance that the main findings are robust to the model specifications. The robustness tests include tests for the reliability of the models.

3.6 Chapter summary

Chapter 3 presents a discussion of the research methodology, research design, target sample, data sources and data collection methods, and data analysis used to address the eight testable hypotheses. The analyses are based on the financial data obtained from listed companies on the Nairobi Securities Exchange for the periods 2003 to 2009. The pooled ordinary least-squares

regression model is used to examine the hypotheses relating to the relationship between boards' of directors characteristics, audit fees and corporate governance disclosure aspects. Control variables drawn from prior studies are included in the research models and act as moderators.

CHAPTER 4

RESULTS AND DISCUSSIONS: THE RELATIONSHIP BETWEEN BOARDS' OF DIRECTORS CHARACTERISTICS AND AUDIT FEES

4.1 Introduction

In this chapter, the results from the model introduced in chapter 2 (section 2.8.2), are presented and interpreted accordingly. The relationship between boards' of directors characteristics (board independence, board diligence, board expertise and board size) and audit fees over a seven-year period for objective 1 is covered.

4.2 Initial data analysis (Dependent variable - audit fees)

4.2.1 Sample representation

Thirty-eight companies form the target sample out of a population of fifty-three companies listed on the Nairobi Securities Exchange at the time the study was done. Out of the thirty-eight companies, the final sample contains thirty companies (appendix 1), representing 78.95%. The reduction in the number of companies from thirty-eight to thirty is primarily due to: (i) four companies were listed after 2003, and (ii) the annual reports were not available for data collection.

From Table 4.1, it can be seen that the highest contributing sector is the industrial and allied sector with 15 companies, the commercial and services sector contributes 7 companies, the alternative investments market segment sector contributes 5 companies and the agricultural sector contributes 3 companies. The expected company-year observations total to 210.

Table 4.1: Sample representation by Sector (Dependent variable – audit fees)

Sector	Number of listed companies	Number of company-year observations	Percentage
Agricultural	3	21	10.00
Commercial and services	7	49	23.33
Industrial and allied	15	105	50.00
Alternative investments market segment	5	35	16.67
Total	30	210	100.00

Source: 2003 – 2009 Research data, author's computations

In the seven-year study period, there are thirty companies forming the sample for each year; this makes 210 company-year observations. Table 4.2 presents the frequency of listed companies across the years.

Table 4.2: Frequency table of listed companies across the years

Year	Frequency	Percentage
2003	30	14.29
2004	30	14.29
2005	30	14.29
2006	30	14.29
2007	30	14.28
2008	30	14.28
2009	30	14.28
Total	210	100.00

Source: 2003 – 2009 Research data, author's computations

4.2.2 Descriptive statistics (audit fees)

Table 4.3 presents descriptive statistics for the variables examined in the study with audit fees as the dependent variable. The mean for the natural log of audit fees is 6.5181. The mean for the natural log of total assets is 9.4726. Financial risk averages 53.29%, and on average complexity is 35.14%. With respect to board independence, on average a majority of the companies have independent directors on the board, at 66.32%. Board members held on average additional 28.41% outside directorships. On average, company leverage is 19.15%, boards have 8 members, and the number of board meetings average 5.

Table 4.3: Descriptive statistics of the variables across all companies

	Minimum	Maximum	Mean		Std. Deviation	N
	Statistic	Statistic	Statistic	Std. Error	Statistic	Statistic
Audit fees (LNFEED)	5.49	7.47	6.5181	.02600	.37684	210
Total assets (LNTA)	6.96	10.89	9.4726	.05016	.72692	210
Financial risk (FR)	.01	.89	.5329	.01216	.17615	210
Complexity (INVRECTA)	.06	.82	.3514	.01392	.20174	210
Leverage (LEV)	.000	.612	.19150	.010498	.152132	210
Board independence (BODI)	.11	.92	.6632	.01459	.21144	210
Board diligence (BODD)	3.00	39.00	4.9571	.27884	4.04083	210
Board expertise (BODE)	.00	.71	.2841	.01024	.14838	210
Board size (BODS)	3.00	15.00	7.8381	.17424	2.52499	210

Source: 2003 – 2009 Research data, author's computations

4.2.3 Univariate analysis (audit fees)

Correlation analysis is used as a preliminary test to measure the relationship between the variables and their strength of the association (Pallant, 2001). Correlation coefficients (Pearson correlations coefficients) provide a summary of the strength and direction of the linear relationship between two variables. Table 4.4 presents the Pearson correlations among the variables. The total assets (LNTA) variable has the strongest correlation with audit fees (LNFEED) of 0.764 and is significant at the 1% level. This is in conformity with studies by Simunic, (1980), Francis and Stokes, (1986), Palmrose, (1986), and Francis and Simon, (1987), which suggest that company size is the most dominant determinant of audit fees.

Board size has a correlation of with audit fees of 0.566; board independence has a correlation with audit fees of 0.411; board expertise has a correlation coefficient of 0.241 and board diligence has a correlation coefficient of 0.179 and all are significant at the 1% level. Company leverage has a correlation with audit fees of 0.145 and is significant at the 5% level. Financial risk is negatively correlated with audit fees at -0.145 and significant at the 5% level.

Some independent variables are significantly correlated with each other, although their correlations do not indicate multi-collinearity as a serious problem. Board size and board independence have a correlation coefficient of 0.441 with $p=0.000$; board expertise and board independence have a correlation coefficient of 0.311 with $p=0.000$; board diligence and board independence have a correlation coefficient of 0.221 with $p=0.001$; board size and board diligence have a correlation coefficient of 0.163 with $p=0.018$.

From Table 4.4, it can be concluded that the correlation between the independent variables is not high since the highest score of two independent variables is 0.441, which is less than 0.700, the standard correlation that is considered to represent high correlation. Therefore, the model fits because all the independent variables are retained. However, care needs to be exercised when interpreting the Pearson correlation coefficients; this is because they cannot provide a reliable indicator of the association in a manner that controls for additional explanatory variables (Pallant, 2001). Therefore, the main analysis is derived from the appropriate multivariate model that is estimated using the pooled least squares regression model.

Table 4.4: Pearson correlations coefficients for the variables used in the regression (audit fees)

	LNFEF	LNTA	FR	INVRECTA	LEV	BODI	BODD	BODE	BODS
LNFEF	1								
LNTA	0.764**	1							
FR	-0.145*	-0.200*	1						
INVRECTA	-0.070	-0.181**	-0.293**	1					
LEV	0.145*	0.235**	0.461**	-0.010	1				
BODI	0.411**	0.369**	-0.148*	0.069	0.194**	1			
BODD	0.179**	0.293**	-0.090	-0.078	-0.020	0.221**	1		
BODE	0.241**	0.102	0.045	-0.044	0.137*	0.311**	-0.102	1	
BODS	0.566**	0.523**	-0.121	-0.136*	-0.021	0.441**	0.163*	-0.047	1

The significance (2-tailed) of the coefficients is obtained using the p-values with * and ** denoting significance at the 5% and 1% levels respectively.

Source: 2003 - 2009 Research data, Researcher's computations

4.2.4 Multivariate analysis (audit fees)

The hypotheses are tested using the pooled ordinary least squares (POLS) regression model with the natural log of audit fees (LNFEF) as the dependent variable. Overall, the results from Table 4.5 show that the audit fees model is significant with F-statistic value of 49.946 and $p=0.000$, suggesting that the model is statistically valid. The R-squared for model 1 (equation 2.1) is 0.665 which means that 66.50% of the variance in audit fees is explained by model 1. The adjusted R-squared is 0.652, which means that 65.20% of the variance would be explained by model 1 if it had been a sample of the whole population. R-squared is not the ideal measure of the best fit of the regression model because R-squared is not invariant to changes in parameterizations of the left-hand variables (Cooke, 1998).

Table 4.5: Linear regression^b results for model 1 (audit fees)

Model 1	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics				
					R Square Change	F Change	df1	df2	Sig. F Change
1	.816 ^a	.665	.652	.22231	.665	49.946	8	201	.000

a. Predictors: (Constant), BODS, LEV, INVRECTA, BODE, BODD, FR, BODI, LNTA

b. Dependent Variable: LNFEF

Source: 2003-2009 Research data, author's computation

Consistent with studies done by Taylor and Baker, (1981), Firth, (1985), Simon et al., (1992), Chan et al., (1993), Anderson and Zeghal, (1994), Collier and Gregory, (1996), Firth, (1997), Langendjik, (1997), and Clatworthy and Peel, (2006), company size is an important factor associated with the external audit fees.

From the output results in Table 4.6, company size (total assets), board expertise and board size are three most important variables in explaining audit fees in the sample. The three make the largest significant unique contribution to the prediction of the dependent variable; the Beta coefficient for company size is 0.640 and is significant ($p=0.000$), for board size is 0.255 and is significant ($p=0.000$) and board expertise is 0.187 and is significant ($p=0.000$). The complexity variable has a Beta coefficient of 0.093 and is significant ($p=0.044$); it makes a significant unique contribution to the prediction of the dependent variable. Financial risk, leverage, board independence and board diligence do not appear to be significant in explaining audit fees for the sampled companies.

Table 4.6: Regression analysis for the audit fees model

R	0.816	Mean square					2.468
R ²	0.665	F					49.946
Adjusted R ²	0.652	F-significance					0.000
Std. error	0.22231						Collinearity statistics
Variables	B	Std Error	Std Coefficient Beta	t-value	t-sig.	Tolerance	VIF
Constant	2.860	0.251		11.376	0.000		
Company size (LNTA)	0.332	0.027	0.640	12.085	0.000	0.594	1.684
Financial risk (FR)	0.053	0.108	0.025	0.492	0.623	0.647	1.545
Complexity (INVRECTA)	0.173	0.086	0.093	2.023	0.044	0.792	1.262
Leverage (LEV)	-0.038	0.123	-0.015	-0.304	0.761	0.671	1.491
Board independence (BODI)	0.019	0.093	0.011	0.202	0.840	0.607	1.648
Board diligence (BODD)	-0.002	0.004	-0.024	-0.545	0.586	0.839	1.192
Board expertise (BODE)	0.474	0.115	0.187	4.102	0.000	0.805	1.242
Board size (BODS)	0.038	0.008	0.255	4.700	0.000	0.567	1.764

Source: 2003-2009 Research data, author's computations.

4.2.5 Test for reliability of the model (audit fees)

To test for multi-collinearity, the variance inflation factor (VIF) is calculated. The results are presented in the collinearity statistics as tolerance and variance inflation factor (VIF). The collinearity tolerance values appear normal with values ranging between 0.567 and 0.839 for model 1, which are well above the cut-off figure of 0.1. Menard, (1995), suggests that a

collinearity tolerance value less than 0.1 almost certainly indicates a serious collinearity problem. In this study, this problem does not arise because the tolerance values are higher than 0.1.

The variance inflation factor (VIF) indicates the reciprocal of the tolerance. Where the VIF values are large, this indicates multi-collinearity. VIF measures how much the variance of an estimated regression coefficient increases if the predictors are correlated (that is, multi-collinear). The collinearity VIF values range between 1.192 and 1.764 for the model. Myres, (1990), suggests that a VIF value of greater than 10 calls for concern; a VIF value range of 2 to 5 has been used as a rule of thumb to indicate presence of multi-collinearity. However, in this study the collinearity VIFs are less than 2, indicating that multi-collinearity amongst observed variables is absent. Table 4.6 shows the collinearity statistics for model 1.

4.2.6 Summary findings (Audit fees)

Table 4.7 presents the summary findings. The hypotheses in chapter 2 (paragraphs 2.6.1 to 2.6.4) are to test the relationship between boards' of directors characteristics and audit fees. The hypotheses are stated as the null and the alternative hypotheses.

The first hypothesis (H_{0n}) posits no relationship between board independence and external audit fees. The result of testing H_{0n} demonstrates a positive but not significant relationship between board independence and external audit fees: the null hypothesis (2.6.1) could not be rejected.

The second hypothesis (H_{1n}) posits no relationship between board diligence and external audit fees. The result of testing H_{1n} demonstrates a negative but not significant relationship between board independence and external audit fees: the null hypothesis (2.6.2) could not be rejected.

The third hypothesis (H_{2n}) posits no relationship between board expertise and external audit fees. The result of testing H_{2n} demonstrates a positive and significant relationship between board expertise and external audit fees: the null hypothesis (2.6.3) is rejected.

The fourth hypothesis (H_{3n}) posits no relationship between the board size and external audit fees. The result of testing H_{3n} demonstrates a positive and significant relationship between board size and external audit fees: the null hypothesis (2.6.4) is rejected.

Table 4.7: Summary findings on the hypotheses (Boards' of directors characteristics and audit fees)

Research Hypotheses: Boards' of directors characteristics and audit fees	Significance Supported	
	Univariate	Multivariate
Total Assets	Supported	Supported
Financial Risk	Supported	Not supported
Complexity	Not supported	Supported
Leverage	Supported	Not supported
Board Independence	Supported	Not supported
Board Diligence	Supported	Not supported
Board Expertise	Supported	Supported
Board Size	Supported	Supported

Source: 2003-2009 Research data, author's computations

4.2.7 Chapter summary

Chapter 4 reports the empirical findings on the relationship between boards' of directors Characteristics and audit fees. The hypotheses variables for board independence, board diligence, board expertise and board size are examined under the audit model. The multivariate regression suggests that board expertise and board size are positively related to audit fees. These may imply that the number of directorships held in other listed companies and the size of the board lead to demand for extensive audit effort from the auditors, resulting in higher audit fees.

The other characteristics of board independence and board diligence provide inconsistent results with audit fees. The control variables of total assets and complexity are significant; the financial risk and company leverage variables are found to be insignificantly related to audit fees. For model 1 (equation 2.1), the overall results show that it is significant; the model is moderate at 66.50% and the F-statistic value is 49.50.

CHAPTER 5

RESULTS AND DISCUSSIONS: COMPLIANCE WITH THE CORPORATE GOVERNANCE DISCLOSURE REQUIREMENT ASPECTS

5.1 Introduction

In this chapter, the results from the model introduced in chapter 2 (section 2.11.2), are presented and interpreted accordingly. The results obtained on corporate governance disclosure aspects over the seven-year period for objectives 2 and 3 are covered.

Corporate governance disclosures are mandatory disclosures about the relationship between a company and its directors; it is a requirement for listed companies in Kenya to state in their annual reports whether they comply with the governance guidelines of the regulatory authority, the Capital Markets Authority. The data collected for the years 2003 to 2009 is used to examine whether the level of corporate governance disclosure by listed companies in Kenya can be described as adequate. In addition, the same data is used to find out the relationship between boards' of directors characteristics and the level of corporate governance disclosure compliance by listed companies on the Nairobi Securities Exchange.

Table 5.1: Sample representation by Sector (Dependent variable – Corporate Governance Disclosure)

Sector	Number of listed companies	Number of company-year observations	Percentage
Agricultural	3	21	10.00
Commercial and services	7	49	23.33
Industrial and allied	15	105	50.00
Alternative investments market segment	5	35	16.67
Total	30	210	100.00

Source: 2003 – 2009 Research data, author's computations

From Table 5.1, it can be seen that the highest contributing sector is the industrial and allied sector with 15 companies, the commercial and services sector contributes 7 companies, the alternative investments market segment sector contributes 5 companies and the agricultural sector contributes 3 companies.

Thirty companies form the sample for each year; this makes 210 company-year observations for the seven-year study period. Table 5.2 presents the frequency of listed companies across the years.

Table 5.2: Frequency table of listed companies across the years

Year	Frequency	Percentage
2003	30	14.3
2004	30	14.3
2005	30	14.3
2006	30	14.3
2007	30	14.3
2008	30	14.3
2009	30	14.2
Total	210	100.0

Source: 2003 – 2009 Research data, author’s computations

5.2 Adequacy of corporate governance disclosure by listed companies in Kenya

5.2.1 Corporate governance disclosure score

Eight companies are excluded from analysis because data in respect of analysing the independent and control variables were not available for 3 companies as their annual reports could not be accessed and five companies did not have data for the seven-year period because they were listed after the year 2003, the start of the study period. The excluded eight companies are presented in appendix 2.

The companies that showed higher adherence (between 91% and 100%) are Company 4 (100%), Company 12 (97%), Company 14 (91%) and Company 23 (93%). This represents 13.3% of the companies analyzed in the sample. The degree of corporate governance disclosure varied for different companies as shown in Table 5.3; the lowest degree of corporate governance disclosure is at 20% while the highest degree of corporate governance disclosure is at 100%.

Table 5.3: Corporate governance disclosure score by companies (Corporate Governance Disclosure Index)

	MAIN INVESTMENTS MARKET SEGMENT (MIMS)	Corporate Governance Disclosure Index
	Agriculture	
1	Company 1	90%
2	Company 2	90%
3	Company 3	64%
	Commercial and Services	
4	Company 4	100%
5	Company 5	90%
6	Company 6	64%
7	Company 7	40%
8	Company 8	36%
9	Company 9	74%
10	Company 10	70%
	Industrial and Allied	
11	Company 11	66%
12	Company 12	97%
13	Company 13	74%
14	Company 14	91%
15	Company 15	66%
16	Company 16	80%
17	Company 17	67%
18	Company 18	80%
19	Company 19	40%
20	Company 20	63%
21	Company 21	80%
22	Company 22	61%
23	Company 23	93%
24	Company 24	86%
25	Company 25	67%
	Alternative Investments Markets Segment (AIMS)	
26	Company 26	23%
27	Company 27	54%
28	Company 28	50%
29	Company 29	70%
30	Company 30	20%

Source: 2003-2009 Research data, author's computations

5.2.2 Degree of corporate governance disclosure (in percentage)

Disclosure indices have been developed in accounting research studies by use of weighted indices method (Botosan, 1997 and Choi, 1973) and un-weighted indices method (Cooke, 1989, 1991; Hossain et al., 1994; Owusu-Ansah, 1998 and Raffournier, 1995). Table 5.4 shows that eight companies, that is, 26.6% have a corporate governance disclosure index of between 81% and 100%; a study by Melis, (2004), posits that a good system of corporate governance requires a good level of disclosure and adequate information to reduce information asymmetries between parties and making corporate insiders accountable for their action. Thus, the corporate governance disclosure level by listed companies in Kenya is low; there is room for improvement for all companies except company 4, which had a disclosure of 100%. The desire of the

regulatory authority is for every listed company to achieve the highest disclosure level, that is, 100%, which is the benchmark. Since the corporate governance disclosure requirements are mandatory for companies listed on the Nairobi Securities Exchange, there is need to strengthen boards' of directors characteristics and aim to attain the desirable 100% disclosure level.

Table 5.4: The degree of disclosure (in percentage) for the companies included in the sample: Average of the years 2003 to 2009

Average Disclosure (%)	Agriculture	%	Commercial and Services	%	Industrial and allied	%	AIMS	%	Total	%
<= 20	0	0	0	0	0	0	1	20	1	3.3
21 to 30	0	0	0	0	0	0	1	20	1	3.3
31 to 40	0	0	2	28.6	1	6.7	0	0	3	10
41 to 50	0	0	0	0	0	0	1	20	1	3.3
51 to 60	0	0	0	0	0	0	1	20	1	3.3
61 to 70	1	33.3	2	28.5	6	40	1	20	10	33.3
71 to 80	0	0	1	14.3	4	26.6	0	0	5	16.9
81 to 90	2	66.7	1	14.3	1	6.7	0	0	4	13.3
91 to 100	0	0	1	14.3	3	20	0	0	4	13.3
Total in final sample	3		7		15		5		30	

Source: 2003-2009 Research data, author's computations

5.3 The relationship between boards' of directors characteristics and the level of corporate governance disclosure compliance

5.3.1 Descriptive statistics for corporate governance disclosure index

Table 5.5 presents descriptive statistics for the variables examined in the study on corporate governance disclosure. The mean for corporate governance disclosure is 0.6824, for the natural log of total assets the mean is 9.4726. With respect to board independence, on average a majority of the companies have independent directors on the board, at 66.32%. Board members held on average additional 28.14% outside directorships. On average, company leverage is 17.90%, boards have 8 members, and the average number of board meetings is 5.

Table 5.5: Descriptive statistics for corporate governance disclosure index for all companies

	Minimum	Maximum	Mean		Std. Deviation	N
	Statistic	Statistic	Statistic	Std. Error	Statistic	Statistic
Corporate governance disclosure index (CGDI)	.20	1.00	.6824	.01563	.22653	210
Total assets (LNTA)	6.96	10.89	9.4726	.05016	.72692	210
Leverage (LEV)	.000	.612	.17897	.010279	.148956	210
Industry type 1 (IT1)	0	1	.10	.021	.301	210
Industry type 2 (IT2)	0	2	.65	.065	.938	210
Industry type 3 (IT3)	0	3	1.50	.104	1.504	210
Industry type (IT4)	0	4	.30	.073	1.064	210
Board independence (BODI)	.11	.92	.6632	.01459	.21144	210
Board diligence (BODD)	3.00	.39.00	4.9571	.27884	4.04083	210
Board expertise (BODE)	.00	.71	.2814	.01141	.16539	210
Board size (BODS)	3.00	15.00	7.8381	.17424	2.52499	210

Source: 2003 – 2009 Research data, author's computations

5.3.2 Univariate analysis (corporate governance disclosure)

As a preliminary test to measure the relationship between the variables and their strength of the association, a correlation analysis is used (Pallant, 2001). Table 5.6 presents the Pearson correlations among the observed variables. The correlation matrix shows that company size (LNTA) with a correlation coefficient of 0.401, board independence (BODI) with a correlation coefficient of 0.455, board size (BODS) are positively correlated with corporate governance disclosure and the correlations are significant at the 1% level. Industry type 1 (IT1) is positively correlated with corporate governance disclosure at 0.195 and the correlation is significant at the 1% level.

Company leverage has a correlation coefficient of 0.297, board expertise has a correlation coefficient of 0.176 and board diligence has a correlation coefficient of 0.173 with significance at the 5% level. Industry type 4 (IT4) is negatively correlated with corporate governance disclosure at -0.287 and the correlation is significant at the 1% level.

Some independent variables are significantly correlated with each other, although their correlations do not indicate multi-collinearity as a serious problem. Board expertise and board independence have a correlation coefficient of 0.474 with $p=0.000$. Board size and board

independence have a correlation coefficient of 0.441 with $p=0.000$; board diligence and board independence have a correlation coefficient of 0.221 with $p=0.001$ and board size and board diligence have a correlation coefficient of 0.163 with $p=0.018$.

From Table 5.6, it can be concluded that the correlation between the independent variables is not high since the highest score of two independent variables is 0.474, which is less than 0.700, the standard correlation that is considered to represent high correlation. Therefore, all the independent variables are retained. The Pearson correlation coefficients interpretation does not provide a reliable indicator of the association in a manner that controls for additional explanatory variables (Pallant, 2001). Therefore, the main analysis is derived from the appropriate multivariate model that is estimated using the pooled least squares regression model.

Table 5.6: Pearson correlations coefficients for the variables in model 2 (CGDI)

	CGDI	LNTA	LEV	IT1	IT2	IT3	IT4	BODI	BODD	BODE	BODS
CGDI	1										
LNTA	0.401**	1									
LEV	0.297*	0.250**	1								
IT1	0.195**	-0.057	0.009	1							
IT2	0.090	0.108	0.269**	-0.231**	1						
IT3	-0.048	0.094	-0.115	-0.333**	-0.692**	1					
IT4	-0.287**	-0.304**	-0.267**	-0.096	-0.199**	-0.287**	1				
BODI	0.455**	0.369**	0.213**	0.118	0.098	0.161*	-0.608**	1			
BODD	0.173*	0.293**	-0.021	-0.079	-0.078	0.157*	-0.068	0.221**	1		
BODE	0.176*	0.089	0.135	-0.072	-0.061	0.232**	-0.248**	0.474**	-0.076	1	
BODS	0.264**	0.523**	0.023	-0.161*	0.384**	-0.102	-0.302**	0.441**	0.163*	-0.018	1

The significance (2-tailed) of the coefficients is obtained using the p-values with * and ** denoting significance at the 5% and 1% levels respectively.

Source: 2003 – 2009 Research data, author's computations

5.3.3 Multivariate analysis (corporate governance disclosure)

Table 5.7 presents the linear regression results. Overall, it can be seen that the corporate governance disclosure index model is significant at the 1% level with F-statistic value of 11.001 and $p=0.000$, suggesting that the model is statistically valid. The R-squared for the model (equation 2.4) is 0.331 meaning that 33.10% of the variance of the dependent variable is accounted for by model 2; the adjusted R-squared is 0.301.

Table 5.7: Linear regression^b results for model 2

Model 2	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics				
					R Square Change	F Change	df1	df2	Sig. F Change
1	.575 ^a	.331	.301	.18939	.331	11.001	9	200	.000

a. Predictors: (Constant), BODS, BODE, LEV, BODD, IT1, IT3, IT4, LNTA, BODI

b. Dependent Variable: CGDI

Source: 2003 – 2009 Research data, author's computations

From the output results in Table 5.8, board independence and company size (total assets) are two most important variables in explaining the level of corporate governance disclosure in the sample. The two make the largest significant unique contribution to the prediction of the dependent variable; the Beta coefficient for board independence is 0.305 and is significant (0.002), while that for company size is 0.238 and significant (0.002).

The company leverage variable has a Beta coefficient of 0.173 and is significant (0.009); it makes a significant unique contribution to the prediction of the dependent variable. The industry type 1 variable has a Beta coefficient of 0.170 and is significant (0.016); it makes a significant unique contribution to the prediction of the dependent variable. Board diligence, industry type 3, industry type 4, board expertise and board size do not appear to be significant in explaining corporate governance disclosure in annual reports for the sampled companies.

Table 5.8: Regression analysis for the corporate governance disclosure model

R	0.575	Mean square					0.395
R ²	0.331	F					11.001
Adjusted R ²	0.301	F-significance					0.000
Std. error	0.18939	Collinearity statistics					
Variables	B	Std Error	Std Coefficient Beta	t-value	t-sig.	Tolerance	VIF
Constant	-0.332	0.196		-1.698	0.091		
Company size (LNTA)	0.074	0.023	0.238	3.163	0.002	0.592	1.689
Leverage (LEV)	0.264	0.100	0.173	2.626	0.009	0.767	1.303
Industry type 1 (IT1)	0.128	0.053	0.170	2.419	0.016	0.680	1.471
Industry type 3 (IT3)	-0.007	0.011	-0.045	-0.600	0.549	0.603	1.659
Industry type 4 (IT4)	0.008	0.017	0.038	0.472	0.637	0.517	1.934
Board independence (BODI)	0.327	0.103	0.305	3.167	0.002	0.360	2.777
Board diligence (BODD)	0.003	0.004	0.060	0.926	0.356	0.806	1.241
Board expertise (BODE)	0.032	0.100	0.023	0.319	0.750	0.627	1.595
Board size (BODS)	0.002	0.008	0.026	0.300	0.764	0.458	2.185

Source: 2003 – 2009 Research data, author's computations

5.3.4 Test for reliability of the model (corporate governance disclosure)

In addition, sensitivity analysis is performed in order to test for multi-collinearity. The results are presented in the collinearity statistics as tolerance and variance inflation factor (VIF). The collinearity tolerance values appear normal with values ranging between 0.360 and 0.806 for model 2, which are well above the cut-off figure of 0.1. This indicates that multi-collinearity problem does not arise. The variance inflation factor (VIF) indicates the reciprocal of the tolerance. In this study, the collinearity VIF values range between 1.241 and 2.777 for the model. This indicates that multi-collinearity amongst observed variables is absent. Table 5.8 shows the collinearity statistics for the corporate governance disclosure index.

5.3.5 Summary findings (corporate governance disclosure)

Table 5.9 summarizes the findings. The hypotheses in chapter 2 (paragraphs 2.9.1 to 2.9.4) are to find out the relationship between boards' of directors characteristics and the level of corporate governance disclosure compliance by listed companies on the Nairobi Securities Exchange. The hypotheses are stated as the null and the alternative hypotheses.

The fifth hypothesis (H_{4n}) posits no relationship between board independence and the level of corporate governance disclosure. The result of testing H_{4n} demonstrates a positive and significant relationship between board independence and the level of corporate governance disclosure: the null hypothesis (2.9.1) is rejected.

The sixth hypothesis (H_{5n}) posits no relationship between board diligence and the level of corporate governance disclosure. The result of testing H_{5n} demonstrates a positive but not significant relationship between board independence and the level of corporate governance disclosure: the null hypothesis (2.9.2) could not be rejected.

The seventh hypothesis (H_{6n}) posits no relationship between board expertise and the level of corporate governance disclosure. The result of testing H_{6n} demonstrates a positive but not significant relationship between board expertise and the level of corporate governance disclosure: the null hypothesis (2.9.3) could not be rejected.

The eighth hypothesis (H_{7n}) posits a negative relationship between the board size and the level of corporate governance disclosure. The result of testing H_{7n} demonstrates a positive but not

significant relationship between board size and the level of corporate governance disclosure: the null hypothesis (2.9.4) could not be rejected.

Table 5.9: Summary findings on the hypotheses (Corporate governance disclosure) – Univariate and multivariate results

Research Hypotheses: Boards' of directors characteristics and corporate governance disclosure index	Significance Supported	
	Univariate	Multivariate
Total Assets	Supported	Supported
Leverage	Supported	Supported
Industry type 1 (IT1)	Supported	Supported
Industry type 2 (IT2)	Not supported	Not supported
Industry type 3 (IT3)	Not supported	Not supported
Industry type 4 (IT4)	Supported	Not supported
Board Independence (BODI)	Supported	Supported
Board Diligence (BODD)	Supported	Not supported
Board Expertise (BODE)	Supported	Not supported
Board Size (BODS)	Supported	Not supported

Source: 2003 – 2009 Research data, author's computations

5.3.6 Chapter summary

Chapter 5 presents the empirical findings regarding, (i) the adequacy of corporate governance disclosure by listed companies in Kenya, and (ii) the relationship between boards' of directors characteristics and the level of corporate governance disclosure compliance by listed companies on the Nairobi Securities Exchange.

On the adequacy of corporate governance disclosure by listed companies in Kenya, eight companies, that is, 26.6% attained the 81% corporate governance disclosure index which is considered as adequate. In this respect, it can be deduced the level of corporate governance disclosure in the Kenyan securities market is low; a good system of corporate governance requires a good level of disclosure and adequate information in order to reduce information asymmetries between parties and making corporate insiders accountable for their action. There is room for improvement for the listed companies on the Nairobi Securities Exchange with the aim of achieving the benchmark disclosure level, that is, 100%.

With regard to the relationship between boards' of directors characteristics and the level of corporate governance disclosure compliance by listed companies on the Nairobi Securities

Exchange, the multivariate regression suggests that board independence is positively related to the level of corporate governance disclosure. This implies that the proportion of independent non-executive directors sitting on the boards of a companies lead to increased compliance with the corporate governance disclosure requirements.

The study finds no evidence that board diligence, board expertise and board size affect the relationship between boards' of directors characteristics and the level of corporate governance disclosure compliance. The control variables of total assets, company leverage and industry type 1 are significant; industry type 2, industry type 3 and industry type 4 are found to be insignificantly related to the level of corporate governance disclosure. For model 2 (equation 2.4), the overall results show that it is significant; the model is low at 33.10% and the F-statistic value is 11.001.

CHAPTER 6

SUMMARY AND CONCLUSIONS

6.1 General

This final chapter presents the summary and conclusions of the empirical investigations examined in this thesis. The purpose of the study was firstly, to contribute to understanding how various boards' of directors characteristics as required by the Capital Markets Act, *Chapter 485A of the Laws of Kenya, (2002)*, affect external audit fees in Kenya. Secondly, the study sought to explore corporate governance disclosure aspects; the adequacy of corporate governance reporting disclosure and the relationship between boards' of directors characteristics and the level of corporate governance disclosure compliance by listed companies on the Nairobi Securities Exchange.

Eight hypotheses are developed to test each variable, four for audit fees as the dependent variable and four for corporate governance disclosure index as the dependent variable. The chapter details the implications and limitations of the investigations; it also gives suggestions for future research.

6.2 Research findings (audit fees)

Objective 1 was to find out the relationship between boards' of directors characteristics (board independence, board diligence, board expertise and board size) and audit fees in Kenya. From the output results in Table 4.6, company size is an important factor associated with the external audit fees. In addition, board expertise and board size are also important variables in explaining audit fees in the sample.

The complexity variable makes a significant unique contribution to the prediction of the dependent variable. Financial risk, leverage, board independence and board diligence do not appear to be significant in explaining audit fees for the sampled companies. Overall, the present study concludes that the findings confirm the proposition of agency theory on the number of directorships held in other listed companies and the size of the board that leads to demand for extensive audit effort from the auditors, resulting in higher audit fees.

6.3 Research findings (corporate governance disclosure)

Objective 2 was to examine whether the level of corporate governance disclosure by listed companies in Kenya can be described as adequate. The companies that showed higher adherence (between 91% and 100%) are Company 4 (100%), Company 12 (97%), Company 14 (91%) and Company 23 (93%). This represents 13.3% of the companies analyzed in the sample.

The results presented in Table 5.4 show that eight companies, that is, 26.6% have a corporate governance disclosure index of between 81% and 100%. A corporate governance disclosure index of 81% and above can be described as adequate. This, therefore, means that 73.4% of the companies in the sample did not attain the adequacy level; the corporate governance disclosure level is low for listed companies on the Nairobi Securities Exchange. The desire of the regulatory authority is for every listed company to achieve the highest disclosure level, that is, 100%, which is the benchmark. Therefore, there is need to strengthen boards' of directors characteristics.

Objective 3 was to find out the relationship between boards' of directors characteristics and the level of corporate governance disclosure compliance by listed companies on the Nairobi Securities Exchange.

Overall, the multivariate regression suggests that board independence is positively related to the level of corporate governance disclosure. Board independence leads to increased compliance with the corporate governance disclosure requirements. On the other hand, the study finds no evidence that board diligence, board expertise and board size have any relationship with the level of corporate governance disclosure compliance.

6.4 Contributions

The findings of this thesis should be of interest to policy makers, boards of directors and academics. In relation to governance practice, the policy makers should continuously recognize the roles played by independent directors as one of the fundamental characteristics of the corporate governance system in Kenya. This study contributes to understanding how boards' of directors characteristics affect external audit fees in Kenya by examining the link between mechanisms of corporate governance, that is, the relationship between boards' of directors characteristics and audit fees.

The study also contributes to the governance disclosure aspects of listed companies in Kenya. It explores the adequacy of the level of corporate governance disclosure for listed companies in Kenya and the relationship between boards' of directors characteristics and the level of corporate governance disclosure compliance. The findings of the study could also assist external auditors in evaluating the effectiveness of the boards of directors in their audit planning. Such assistance would assist the external auditors in identifying the best time to be allocated for their audit engagements in terms of effort in order to determine whether to reduce or increase audit effort and the amount of audit fees to be charged.

6.5 Limitations of this study

This thesis is subject to several limitations. First, this study employs only four variables that are related to corporate governance. There are many other corporate governance variables, which may affect the dependent variables under the study, but they were not captured in the methodologies used. Those variables that were not captured form the basis for further studies.

Secondly, the findings of this study would be more accurate if the study covers the whole population of listed companies on the Nairobi Securities Exchange. This would provide greater generalization of the relationship between boards' of directors characteristics and audit fees and on the relationship between boards' of directors characteristics and the level of corporate governance disclosure compliance by listed companies on the Kenyan securities market. The interpretation of the results is subject to quantitative data only; the restriction of analysis of data is due to usage of numerical data only. Qualitative information was lacking, making explicit variables to be chosen based on theoretical foundations.

Thirdly, the common determinants of audit fees have been controlled as used in prior studies. These common determinants include company size, financial risk, complexity and company leverage. The corporate governance disclosure index has been controlled using control variables from a review of prior corporate governance disclosure literature; these include company size, company leverage and industry type. Many other variables could be used as control variables; these include profitability, multiple listings and return on assets.

Fourthly, the measures used are merely proxies for various constructs; the corporate governance variables do not capture the actual monitoring processes that take place within the companies.

For example, board diligence variable is not able to discern the quality of meetings and the issues discussed in those meetings. Other forms of communication between boards of directors and external monitors such as auditors and the regulators are not captured.

Lastly, data for the study was collected from annual reports. This data may not explain the linkage between boards' of directors characteristics comprising the board variables, audit fees and corporate governance disclosure aspects completely.

6.6 Recommendations for further research (audit fees and characteristics of boards of directors)

There are several ways to extend the studies examined in this thesis boards' of directors characteristics and audit fees:

- a) further research on the relationship between boards' of directors characteristics and audit fees can be carried out using other variables such as ownership structures. Data for such variables may not be available in annual reports but may be available from other sources like through surveys;
- b) only a few boards' of directors characteristics were tested in this study. Further research can be done using variables such as ownership structure, internal audit, accounting and finance expert on the boards of directors and audit quality. Such study could increase the understanding of the relationship between boards' of directors characteristics and audit fees in emerging markets;
- c) the quality of boards' of directors meetings and the issues discussed should be discerned and other forms of communications between boards of directors and external monitors should be captured in future researches, for example, via case studies or qualitative researches;
- d) financial and insurance companies are excluded from this research because of the more highly regulatory environment applicable to this sector. Further research using a sample from the this sector can be carried out to find out whether there is consistency with regard to the relationship between boards' of directors characteristics and audit fees.

6.7 Recommendations for further research (corporate governance disclosure and characteristics of boards of directors)

The study on the level of corporate governance disclosure aspects can be extended because:

- a) only a few boards' of directors characteristics were tested in this study; further research can be done using a qualitative study such as interviews, on the factors influencing corporate governance disclosure compliance and the adequacy of corporate governance disclosure;
- b) further research on the relationship between boards' of directors characteristics and the level of corporate governance disclosure compliance and adequacy of corporate governance disclosure by listed companies on the Nairobi Securities Exchange can be carried out using other variables such as ownership structures. Data for such variables may be available from other sources like through surveys;
- c) further research using a sample from the financial and insurance sector can be carried out to find out whether there is consistency with regard to the adequacy of corporate governance disclosure and on the relationship between boards' of directors characteristics and the level of corporate governance disclosure compliance; and
- d) only a few corporate governance disclosure requirements were examined. Further research can be carried out to cover all the corporate governance disclosure requirements.

REFERENCES

- Abbott, L., Parker, S., Peters, G. and Raghunandan, K., (2003), 'The association between audit committee characteristics and audit fees', *Auditing: Journal of Practice and Theory*, 22: pp. 17-32.
- Abbott, L., Parker, S. and Peters, G., (2004), 'Audit committee characteristics and restatements', *Auditing: A Journal of Practice and Theory*, 23, 1: pp. 69-78.
- Adams, R. and Mehren, H., (2003), 'Is corporate governance different for bank holding companies?', *Economic Policy Review - Federal Reserve Bank of New York*, 9, 1: pp. 123-143.
- Adeyemi, S. and Fagbemi, T., (2010), 'Audit quality, corporate governance and firm characteristics in Nigeria', *International Journal of Business and Management*, 5, 5: pp. 169-179.
- Accountants Act (*Chapter 531, Laws of Kenya, 2008*), Government Printer, Nairobi.
- Ahmed, K. and Nicholls, D., (1994), 'The impact of non-financial company characteristics on mandatory disclosure compliance in developing countries: The case of Bangladesh', *The International Journal of Accounting*, 29: pp. 62-77.
- Ahmed, K. and Courtis, J.K., (1999), 'Association between corporate characteristics and disclosure levels in annual reports: A meta-analysis', *British Accounting Review*, 31: pp. 35-61.
- Anderson, R.C., Mansi, S.A. and Reeb, D.M., (2004), 'Board characteristics, accounting report integrity, and the cost of debt', *Journal of Accounting and Economics*, 37, 3: pp. 315-342.
- Anderson, T. and Zeghal, D., (1994), 'The pricing of audit services: Further evidence from the Canadian market', *Accounting and Business Research*, 24: pp. 195-207.
- Baker, C.R. and Owsen, D.M., (2002), 'Increasing the role of auditing in corporate governance', *Critical Perspectives on Accounting*, 13: pp. 783-795.
- Barako, D.G., (2007), 'Determinants of voluntary disclosures in Kenyan companies' annual reports', *African Journal of Business Management*, 1, 5: pp. 113-128.
- Beasley, M.S., (1996), 'An empirical analysis of the relation between the board of director composition and financial statement fraud', *The Accounting Review*, 71, 4: pp. 443-465.

- Beasley, M.S. and Petroni, K.R., (2001), 'Board independence and audit-firm type', *Auditing*, 20: pp. 97-114.
- Bedard, J.C. and Johnstone, K.M., (2004), 'Earnings manipulation risk, corporate governance risk, and auditors' planning and pricing decisions', *The Accounting Review*, 79, 2: pp. 277-304.
- Berle, A.A. and Means, G.C., (1932), '*The Modern Corporation and Private Property*', Macmillan, New York.
- Bonner, S., Zoe-Vonna, P. and Suan, Y., (1998), 'Fraud type and auditor litigation: An analysis of SEC Accounting and Auditing enforcement releases', *The Accounting Review*: pp. 503-532.
- Botosan, C.A., (1997), 'Disclosure level and the cost of equity capital', *Accounting Review*, 72, 3: pp. 323-349.
- Bourke, P., (1989), 'Concentration and other determinants of bank profitability in Europe, North America and Australia,' *Journal of Banking and Finance*, 13: pp. 65-79. Retrieved from <http://ideas.repec.org/a/eee/jbfina/v13y1989i1p65-79.html>. Last accessed on 08/06/2012.
- Boyd, B., (1990), 'Corporate linkages and organizational environment: A test of the resource dependence model', *Strategic Management Journal*, 11: pp. 419-430.
- Bryan, S. and Klein, A., (2005), 'Non-management director options, board characteristics, and future firm investments and performance', working paper, New York School of Law and Economics, New York.
- Bushman, R., Chen. Q., E. Engel, E. and Smith, A., (2004), 'Financial accounting information, organizational complexity and corporate governance systems', *Journal of Accounting and Economics*, 37, 2: pp. 167-201.
- Buzby, S. L., (1975), 'Company size, listed versus unlisted stocks, and the extent of financial disclosure', *Journal of Accounting Research*, 13, 1: pp. 16-37.
- Byrne, J., (1996), 'And you thought CEOs were overpaid', *Business Week*: pp. 26-34.
- Cadbury, A., (1992), 'Committee on the financial aspects of corporate governance compliance with the Code of Best Practice', Gee, London.
- Cadbury Committee Report, (1992), 'Report of the Cadbury committee on the financial aspects of corporate governance', Gee, London, retrieved from <http://www.ecgi.org/codes/documents/cadbury.pdf>. Last accessed on 29/03/2012.

- Cadbury, A., (1997), 'Corporate governance: An update on critical issues', *SES Journal*, August.
- Cadbury, A., (2000), 'Global corporate governance forum', World Bank, retrieved from http://www.emeraldplanet.asia.com/corporate_governance.html. Last accessed on 29/01/2011.
- Cameran, A., (2005), 'Audit fee and the large auditor premium in the Italian market', *International Journal of Auditing*, 9: pp. 129-146.
- Capital Markets (Securities) (Public Offers, Listing and Disclosures) Regulations, (2002), Government Printer, Nairobi.
- Carcello, J.V. and Neal, T.L., (2000), 'Audit committee composition and auditor reporting', *The Accounting Review*, 75, 4: pp. 453-467.
- Carcello, J., Hermanson, D., Neal, T. and Riley, R., (2002), 'Board characteristics and audit fees', *Contemporary Accounting Research*, 19: pp. 365-384.
- Carcello, J.V., (2009), 'Governance and the common good', *Journal of Business Ethics*, 89: pp. 11-18.
- Carson, E. and Fargher, N., (2007), 'Note on audit fee premiums to client size and industry specialization', *Accounting and Finance*, 47, 3: pp. 423-446.
- Cerf, R.A., (1961), *Corporate Reporting and Investment Decisions*, the University of California Press, Berkley.
- Chan, P., Ezzamel, M. and Gwilliam, D., (1993), 'Determinants of audit fees for quoted UK companies', *Journal of Business Finance and Accounting*, 20: pp. 765-786.
- Chau, G.K. and Gray, S.J., (2002), 'Ownership structure and corporate voluntary disclosure in Hong Kong and Singapore', *The International Journal of Accounting*, 37, 5: pp. 247-265.
- Chau, G. and Leung, P., (2006), 'The impact of board composition and family ownership on audit committee formation: Evidence from Hong Kong', *Journal of International Accounting, Auditing and Taxation*, 15: pp. 1-15.
- Chen, C.J.P. and Jaggi, B., (2000), 'Association between independent non-executive directors, family control and financial disclosures in Hong Kong', *Journal of Accounting and Public Policy*, 19, 4: pp. 285-310.
- Chen, X., Ender, P.B., Mitchell, M. and Wells, C., (2003), 'Regression with Stata', available at <http://www.ats.ucla.edu/stata/webbooks/reg/>. Last accessed on 17/03/2012.

- Cheng, C.M. and Courtenay, S.M., (2006), 'Board composition, regulatory regime and voluntary disclosure', *International Journal of Accounting*, 41, 3: pp. 262-298.
- Choi, F.D.S., (1973), 'Financial disclosure and entry to the European capital market', *Journal of Accounting Research*, 11: pp. 159-175.
- Chow, C., (1982), 'The demand for external auditing: Size, debt and ownership influences', *Accounting Review*, 57, 2: pp. 272-292.
- Chow, C.W. and Wong-Boren, A., (1987), 'Voluntary financial disclosure by Mexican corporations', *The Accounting Review*, 62, 3: pp. 533-541.
- Clatworthy, M.A. and Peel, M.J., (2006), 'The effect of corporate status on external audit fees: Evidence from the UK', *Journal of Business Finance and Accounting*: pp. 1-33.
- CMA, (2002), Capital Markets Act, *Chapter 485A of the Laws of Kenya, Guidelines on Corporate Governance Practices by Public Listed Companies in Kenya*, Kenya Gazette Notice No.3362, Government Printer, Nairobi.
- Cobbin, P.E., (2002), 'International dimensions of the audit fees determinants literature', *International Journal of Auditing*, 6: pp. 53-77.
- Cohen, J., Krishnamoorthy, G. and Wright, A., (2004), 'The corporate governance mosaic and financial reporting quality', *Journal of Accounting Literature*, 23: pp. 87-152.
- Collier, P. and Gregory, A., (1996), 'Audit committee effectiveness and the audit fees', *The European Accounting Review*, 5: pp. 177-198.
- Companies Act (Chapter 486, *Laws of Kenya*, 1962), Government Printer, Nairobi.
- Conger, J.A., Finegold, D. and Lawler, E.E., (1998), 'Appraising boardroom performance', *Harvard Business Review*, 76, 1: pp. 136-148.
- Cooke, T.E., (1989), 'Voluntary corporate disclosure by Swedish companies', *Journal of International Financial Management and Accounting*, 1, 2: pp. 113-123.
- Cooke, T.E., (1991), 'An assessment of voluntary disclosure in the annual reports of Japanese corporations', *The International Journal of Accounting*, 26: pp. 174-189.
- Cooke, T.E., (1992), 'The impact of size, stock market listing, and industry type on disclosure in the annual reports of Japanese listed corporations', *Accounting and Business Research*, 22, 87: pp. 229-237.
- Cooke, T.E., (1998), 'Regression analysis in accounting disclosure studies', *Accounting and Business Research*, 28, 3: pp. 209-224.

- Cotter, J., Shivdasani, A. and Zenner, M., (1997), 'Do independent directors enhance target shareholder wealth during tender offers?' *Journal of Financial Economics*, 43: pp. 195-218.
- Craswell, A., Francis, J. and Taylor, S., (1995), 'Auditor brand name reputations and industry specializations', *Journal of Accounting and Economics*, 20: pp. 297-312.
- Craswell, A.T. and Francis, J.R., (1999), 'Pricing initial audit engagements: a test of competing theories', *The Accounting Review*, 74, 2: pp. 201-216.
- Daily, C.M., Dalton, D.R. and Cannella Jr., A.A., (2003), 'Corporate governance: Decades of dialogue and data', *Academy of Management Review*, 28, 3: pp. 371-382.
- Dalton, D.R., Daily, C.M., Ellstrand, A.E. and Johnson, J.L., (1998), 'Meta-analytic reviews of board composition, leadership structure, and financial performance', *Strategic Management Journal*, 19: pp. 269-290.
- Davidson, R.A. and Gist, W.E., (1996), 'Empirical evidence on the functional relation between audit planning and total audit effort', *Journal of Accounting Research*, 34 (spring): pp.111-124.
- Davis, L., Ricchiute, D. and Tropeter, G., (1993), 'Audit effort, audit fees, and the provision of non-audit services to audit clients', *The Accounting Review*, (January): pp. 135-150.
- Dechow, P.M., Sloan, R.G. and Sweeney, A.P., (1996), 'Causes and consequences of earnings manipulation: An analysis of firms subject to enforcement actions by the SEC', *Contemporary Accounting Research*, 13, 1: pp. 1-36.
- Defond, M.L. and Jiambalvo, J., (1994), 'Debt covenant violation and manipulation of accruals', *Journal of Accounting and Economics*, 17: pp. 145-176.
- Denis, D.K. and McConnell, J.J., (2003), 'International corporate governance', *Journal of Financial and Quantitative Analysis*, 38, 1: pp. 1-36.
- Eichenseher, J.W. and Shields, D., (1985), 'Corporate director liability and monitoring preferences', *Journal of Accounting and Public Policy*, 4: pp. 13-31.
- Eilifsen, A., Knechel, W.R. and Wallage P., (2001), 'External assurance services and strategic business risk: an international field study,' *Accounting Horizons*, (September): pp. 193-207.
- Eilifsen, A., Messier Jr., W.F., Glover, S.M. and Prawitt, D.F., (2009), 'Auditing and Assurance services', 2nd international edition, McGraw-Hill Education, Glasgow.
- Eisenhardt, K.M., (1989), 'Agency theory: An assessment and review', *The Academy of Management Review*, 14, 1: pp. 57-74.

- Eng, L. and Mak, Y., (2003), 'Corporate governance and voluntary disclosure', *Journal of Accounting and Public Policy*, 22: pp. 325-345.
- Evans, J. and Weir, C., (1995), 'Decision processes, monitoring, incentives and large firm performance in the UK', *Management Decision*, 33, 6: pp. 32-37.
- Fama, E.F., (1980), 'Agency problems and the theory of the firm', *Journal of Political Economy*, 88, 2: pp. 288-307.
- Fama, E.F. and Jensen, M., (1983), 'Agency problems and residual claims', *Journal of Law and Economics*, 26, 2: pp. 327-349.
- Felo, A.J. and Solieri, S.A., (2009), 'Are all audit committee financial experts created equally?' *International Journal of Disclosure and Governance*, 6, 2: pp. 150-166.
- Ferris, S.P., Jagannathan, M. and Pritchard, A.C., (2003), 'Too busy to mind the business: Monitoring by directors with multiple board appointments', *Journal of Finance*, 58, 3: pp. 1087-1111.
- Firth, M., (1979), 'The impact of size, stock market listing, and auditors on voluntary disclosure in corporate annual reports', *Accounting and Business Research*, 4, 33: pp. 273-280.
- Firth, M., (1985), 'An analysis of audit fees and their determinants in New Zealand', *Auditing: Journal of Practice and Theory*, 4: pp. 23-37.
- Firth, M., (1993), 'Price setting and the value of a strong brand name', *International Journal of Research in Marketing*, 10: pp. 381-386.
- Firth, M., (1997), 'The Provision of non-audit services and the pricing of audit fees', *Journal of Business Finance and Accounting*, 24: pp. 511-525.
- Forker, J.J., (1992), 'Corporate governance and disclosure quality', *Accounting and Business Research*, 22, 86: pp. 111-124.
- Francis, J.R., (1984), 'The effect of audit firm size on audit prices: A study of the Australian market', *Journal of Accounting and Economics*, 6: pp. 133-151.
- Francis, J.R. and Stokes, D.T., (1986), 'Audit prices, product differentiation and scale economics: Further evidence from the Australian market', *Journal of Accounting Research*, 24: pp. 383-393.
- Francis, J.R. and Simon, D.T., (1987), 'A test of audit pricing in the small-client segment of the U.S. audit market', *The Accounting Review*, 62, 1: pp. 145-157.

- Francis, J. and Wilson, E., (1988), 'Auditor changes: A joint test of theory relating to agency costs and auditor differentiation', *Accounting Review*, 63, 4: pp. 663-683.
- Goodwin-Stewart, J. and Kent, P., (2006), 'Relation between external audit fees, audit committee characteristics and internal audit', *Accounting and Finance*, 46: pp. 387-404.
- Gujarati, D., (2003), 'Basic econometrics', 5th edition, McGraw-Hill/ Irwin, New York.
- Gul, F.A. and Tsui, J.S.L., (1998), 'A test of the free cash flow and debt monitoring hypotheses: Evidence from audit pricing', *Journal of Accounting and Economics*, 24: pp. 219-237.
- Gul, S., Irshad, F. and Zaman, K., (2011), 'Factors affecting bank profitability in Pakistan', *The Romanian Economic Journal*, 39: pp. 61-87.
- Hair, J.F., Black, W.C., Babin, B.J. and Anderson, R.E., (2010), 'Multivariate data analysis: A global perspective', 7th edition, Pearson Prentice Hall: Upper Saddle River, New Jersey.
- Haniffa, R.M. and Cooke, T.E., (2002), 'Culture, corporate governance and disclosure in Malaysian corporations', *Abacus*, 38, 3: pp. 317-349.
- Hay, D. and Knechel, W.R., (2004), 'Evidence on the association among elements of control and external assurance'. Working paper, University of Auckland.
- Hay, D., Knechel, W.R. and Wong N., (2006), 'Audit fees: A meta-analysis of the effect of supply and demand attributes', *Contemporary Accounting Research*, 23, 1: pp. 141-191.
- Hay, D., Knechel, W.R. and Ling, H., (2008), 'Evidence on the impact of internal control and corporate governance on audit fees', *International Journal of Auditing*, 12, 1: pp. 9-24.
- Heninger, W.G., (2001), 'The association between auditor litigation and abnormal accruals', *Accounting Review*, 76, 1: pp. 111-126.
- Hillman, A.J. and Dalziel, T., (2003), 'Boards of directors and firm performance: Integrating agency and resource dependence perspectives', *Academy of Management Review*, 28, 3: pp. 383-396.
- Ho, S.M.S. and Wong, K.R., (2001), 'A study of the relationship between corporate governance structures and the extent of voluntary disclosure', *Journal of International Accounting, Auditing and Taxation*, 10: pp. 139-156.
- Hossain, M., Perera, M.H.B. and Rahman, A.R., (1995), 'Voluntary disclosure in the annual reports of New Zealand companies', *Journal of International Financial Management and Accounting*, 6: pp. 69-87.

- IASB, (2001), IASB update, April, IASB Publications Department, London.
- IFAC, (2009), 'International Federation of Accountants', *Rebuilding Public Confidence in Financial Reporting: An International Perspective*, retrieved from <http://web.ifac.org/publications/ifac-policy-position-papers-reports-and-comment-letters/reports-1#developments-in-the-financial-reporting-supply-chain-results-from-a-global-study-among-ifac-member-bodies>. Last accessed on 7/05/2011.
- IFAC, (2009), International Federation of Accountants, *Assessment of the Regulatory and Standard Setting Framework-Institute of Certified Public Accountants of Kenya*, IFAC Member Body Compliance Program, retrieved from http://www.ifac.org/ComplianceAssessment/published_survey.php. Last accessed on 18/04/2011.
- ISAR, (2006), 'Guidance on good practice in corporate governance disclosures', retrieved from http://www.unctad.org/en/dosc/iteteb20063_en.pdf. Last accessed on 18/04/2011.
- Javaid, S., Anwar, J., Zaman K. and Gafoor, A., (2011), 'Determinants of bank profitability in Pakistan: Internal factor analysis', *Mediterranean Journal of Social Sciences*, 2, 1: pp. 59-78.
- Jensen, M. and Meckling, W., (1976), 'Theory of firm: Managerial behaviour, agency costs, and capital structure', *Journal of Financial Economics*, 3: pp. 305-360.
- Jensen, M.C., (1993), 'The modern industrial revolution, exit, and the failure of internal control systems', *Journal of Finance*, 48: pp. 831-880.
- Jensen, M.C., (2001), 'Value maximization, stakeholder theory and the objective function', *Journal of Applied Corporate Finance*, 14, 3: pp. 8-21.
- Johnson, R.R. and Kuby, P.J., (2007), *Business Economics*: pp. 713.
- Johnstone, K.M. and Bedard, J.C., (2001), 'Engagement planning, bid pricing, and client response in the market for initial attest engagement', *The Accounting Review*, 76, 2: pp. 199-220.
- Joshi, P.L. and Al-Bastaki, H., (2000), 'Determinants of Audit Fees: Evidence from the companies listed in Bahrain', *International Journal of Auditing*, 4: pp. 129-138.
- Klein, A., (2002), 'Audit committee, board of director characteristics and earnings management', *Journal of Accounting and Economics*, 33, 3: pp. 375-400.
- Krishnan, J., (2005), 'Audit committee quality and internal control: an empirical analysis', *The Accounting Review*, 80, 2: pp. 649-675.

- Lang, M. and Lundholm, R., (1993), 'Cross-sectional determinants of analyst's ratings of corporate disclosures', *Journal of Accounting Research*, 31: pp. 246-271.
- Langendijk, H., (1997), 'The market for audit services in the Netherlands', *The European Accounting Review*, 6: pp. 253-264.
- Larcker, D.F., Richardson, S.A. and Tuna, I., (2007), 'Corporate governance, accounting outcomes, and organizational performance', *The Accounting Review*, 82, 4: pp. 963-1008.
- Lipton, L. and Lorsch, J., (1992), 'A modest proposal for improved corporate governance', *The Business Lawyer*, 48: pp. 59-77.
- Maher, M.W., Tiessen, P., Colson, R. and Broman, A.J., (1992), 'Competition and audit fees', *The Accounting Review*, 67: pp. 199-211.
- McConomy, B. and Bujaki, M., (2000), 'Corporate governance: Enhancing shareholder value', *CMA Management*, 74, 8: pp. 10-13.
- McNally, G., Eng, L. and Hasseldine, C., (1982), 'Corporate financial reporting in New Zealand: An analysis of user preferences, corporate characteristics and disclosure practices for discretionary information', *Accounting and Business Research*, 13: pp. 11-20.
- Menard, S., (1995), 'Applied logistic regression analysis', *Sage University paper series on qualitative applications in the social sciences*, s: Thousands Oaks, CA, Sage: pp. 07-106.
- Meek, G.K., Roberts, C. and Gray, S.J., (1995), 'Factors influencing voluntary annual report disclosures by US, UK and Continental European multinational corporations', *Journal of International Business Studies*, 26, 3: pp. 555-572.
- Melis, A., (2004), 'Financial reporting, corporate communication and governance', *Corporate Ownership and Control*, 1, 2: pp. 31-37.
- Miltz, D., Calomme, G.J. and Willekens, M., (1991), 'A risk-based allocation of internal audit time: A case study', *Auditing: Journal of Practice and Theory*, 10, 2: pp. 49-61.
- Muniandy, B., (2007), 'CEO duality, audit committee effectiveness, and audit risks', *Managerial Auditing Journal*, 23, 7: pp. 716-728.
- Myers, R., (1990), '*Classical and modern regression with applications*', 2nd edition, MA Duxbury, Boston.

- NACD, (1996), National Association of Corporate Directors, '*Report of the NACD Blue Ribbon Commission on director professionalism*'. NACD: Washington, DC, retrieved from www.worldcat.org/title/report-of-the-nacd-blue-ribbon-commission-on-director-professionalism/35923075. Last accessed on 26/04/2011.
- OECD, (2004), '*OECD Principles of Corporate Governance*', retrieved from www.oecd.org/dataoecd/32/18/31557724.pdf. Last accessed on 18/02/2011.
- O'Keefe, T., Simunic, D.A. and Stein, M.T., (1994), 'The Production of Audit Services: evidence from a major public accounting firm', *Journal of Accounting Research*, 32: pp. 241-261.
- O'Sullivan, N. and Diacon, S.R., (1994), 'Audit fee determination and governance structure: some empirical evidence from the UK insurance companies', *Geneva Papers on Risk and Insurance*, 19: pp. 70-84.
- O'Sullivan N., (1997), 'Insuring the agents: The role of directors' and officers' insurance in corporate governance', *Journal of Risk and Insurance*, 64: pp. 545-556.
- O'Sullivan, N., (2000), 'The impact of board composition and ownership on audit quality: evidence from large UK companies', *British Accounting Review*, 32, 4: pp. 397-414.
- Owusu-Ansah, S., (1998), 'The impact of corporate attributes on the extent of mandatory disclosure and reporting by listed companies in Zimbabwe', *The International Journal of Accounting Review*, 33: pp. 605-631.
- Pallant, J., (2001), '*SPSS survival manual: A step-by-step guide to data using SPSS for windows (Version 10 and 11)*', Open University Press, Philadelphia.
- Palmrose, Z., (1986), 'Audit fees and auditor size, further evidence', *Journal of Accounting Research*, 24 (spring): pp. 97-110.
- Palmrose, Z., (1989), 'The relation of audit contract type to audit fees and hours', *The Accounting Review*, 64, 3: pp. 488-499.
- Peel, M. and Clatworthy, M.A., (2001), 'The relationship between government structure and audit fees pre-Cadbury: Some empirical findings', *Corporate Governance*, 9, 4: pp. 286-297.
- Pfeffer, J. and Salancik, G., (1978), '*The external control of organizations: A resource - dependence perspective*', Harper and Row, New York.
- Pound, J., (1995), 'The promise of the governed corporation', *Harvard Business Review*, 73 (March-April): pp. 89-98.

- Raffournier, B., (1995), 'The determinants of voluntary financial disclosure by Swiss listed companies', *The European Accounting Review*, 4: pp. 261-280.
- Reilly, S., (2003), '*Competency and training, Selected issues in corporate governance: Regional and country experiences*, United Nations Conference on Trade and Development', New York and Geneva: pp. 36-38.
- Salleh, Z., Stewart, J. and Manson, S., (2006), 'The impact of board composition and ethnicity on audit: Evidence from Malaysian companies', *Malaysian Accounting Review*, 5, 2: pp. 89-98.
- Saudagaran, S.M., (2003), 'The accounting world post-Enron, Tyco, Vivendi, Worldcom, Xerox ...: Reflections on being part of the solution', *Malaysian Accounting Review*, 2, 1: pp. 2-12.
- Saunders, M., Lewis, P. and Thornhill, A., (2007), 'Research methods for business students', 4th edition, Prentice Hall, London.
- Shleifer, A. and Vishny, R.W., (1997), 'A survey of corporate governance', *The Journal of Finance*, LII, 2: pp. 737-783.
- Short, H., Keasey, K., Wright, M. and Hull, A., (1999), 'Corporate governance: From accountability to enterprise', *Accounting and Business Research*, 29: pp. 337-352.
- Simon, D., Teo, S. and Trompeter, G., (1992), 'A comparative study of the market for audit services in Hong Kong, Malaysia and Singapore', *International Journal of Accounting*, 27: pp. 234-240.
- Simon, D. and J. Francis, J., (1988), 'The effects of auditor change on audit fees: Tests of price-cutting and price recovery', *The Accounting Review*, 63: pp. 255-269.
- Simunic, D.A., (1980), 'The pricing of audit services: Theory and evidence', *Journal of Accounting Research*, 18 (spring): pp. 161-190.
- Simunic, D.A. and M. Stein, M.T., (1987), '*Product differentiation in Auditing: Auditor choice in the market for unseasoned new issues*', Canadian Certified General Accountants' Research Foundation, Vancouver.
- Simunic, D.A. and Stein, M.T., (1996), 'The impact of litigation risk on audit pricing: A review of the economics and the evidence', *Auditing: A Journal of Practice and Theory*, 15, 2: pp. 145-149.
- Solomon, J.F., (2007), 'Corporate governance and accountability', 2nd edition, Wiley, New York.

- Spira, L.F., (2001), 'Enterprise and accountability: Striking a balance, management decision', 39, 9: pp. 739-748.
- Sun, J. and Liu, G., (2011), 'Client-specific litigation risk and audit quality differentiation', *Managerial Auditing Journal*, 26, 4: pp. 300-316.
- Taylor, H. and Glezen, W., (1997), 'Auditing, an assertions approach', 7th edition, Wiley, New York.
- Taylor, M.E. and Baker, R.L. (1981), 'An analysis of the external audit fee', *Accounting and Business Research*, winter: pp. 55-60.
- Tsamenyi, M., Enninful-Adu, E. and Onumah, J., (2007), 'Disclosure and corporate governance in developing countries: Evidence from Ghana', *Managerial Auditing Journal*, 22, 3: pp. 319-334.
- Tsui, J., Jaggi B. and Gul, F., (2001), 'CEO domination, discretionary accruals and audit fees', *Journal of Accounting, Auditing and Finance*, 16: pp. 189-207.
- Vafeas, N., (1999), 'Board meeting frequency and firm performance', *Journal of Financial Economics*, 53: pp. 113-142.
- Vafeas, N., (2005), 'Audit committees, boards, and the quality of reported earnings', *Contemporary Accounting Research*, 22, 4: pp. 1093-1122.
- Wallace, R.S.O. and Naser, A., (1995), 'Firm-specific determinants of the comprehensiveness of mandatory disclosure in the corporate annual reports of firms listed on the stock exchange of Hong Kong', *Journal of Accounting and Public Policy*, 14: pp. 311-368.
- Wallace, R.S.O., Naser, K. and Mora, A., (1994), 'The relationship between the comprehensiveness of corporate annual reports and firm specific characteristics in Spain', *Accounting Business Research*, 25, 97: pp. 41-53.
- Wallace, W.A., (1991), 'Monograph 1 The economic role of auditing in free and regulated markets': pp. 9-56.
- Wallace, W.A., (1989), 'Are audit fees sufficiently risk adjusted?' *Advances in Accounting*, (Supplement 1): pp. 3-38.
- Walsh, J.P. and Seward, J.K., (1990), 'On the efficiency of internal and external corporate control mechanisms', *Academy of Management Review*, 15, 3: pp. 421-458.
- Watts, R. and Zimmerman, J., (1983), 'Agency problems, auditing and the theory of the firm: some evidence', *Journal of Law and Economics*, 26: pp. 613-634.

- Weir, C. and Laing, D. (2003), 'Ownership structure, board composition and the market for corporate control in the UK: An empirical analysis', *Applied Economics*, 35: pp. 1747-1759.
- World Bank, (2001), *Report on the observance of standards and codes (ROSC) - Kenya*, retrieved from <http://www.worldbank.org/ifa/kenyarosc.pdf>. Last accessed on 5/04/2011.
- Yatim, P., Kent, P. and Clarkson, P., (2006), 'Governance structures, ethnicity and audit fees of Malaysian listed firms', *Managerial Auditing Journal*, 21: pp. 757-782.
- Yermack, D., (1996), 'Higher market valuation of companies with a small board of directors', *Journal of Financial Economics*, 40, 2: pp. 185-211.
- Zahra, S. and Pearce, J., (1989), 'Boards of directors and corporate financial performance: A review and integrative model', *Journal of Management*, 15: pp. 291-244.

APPENDICES

Appendix 1: Non- Financial Public Listed Companies included in the sample at the time of carrying out the study

	MAIN INVESTMENTS MARKET SEGMENT (MIMS)	Audit Firm
[A]	Agriculture	
1	Company 1	A
2	Company 2	B
3	Company 3	D
[B]	Commercial and Services	
4	Company 4	A
5	Company 5	D
6	Company 6	A
7	Company 7	D
8	Company 8	A
9	Company 9	D
10	Company 10	A
[C]	Industrial and Allied	
11	Company 11	A
12	Company 12	D
13	Company 13	D
14	Company 14	C
15	Company 15	C
16	Company 16	A
17	Company 17	A
18	Company 18	A
19	Company 19	A
20	Company 20	B
21	Company 21	A
22	Company 22	A
23	Company 23	B
24	Company 24	B
25	Company 25	A
[D]	Alternative Investments Markets Segment (AIMS)	
26	Company 26	A
27	Company 27	C
28	Company 28	A
29	Company 29	A
30	Company 30	D

Source: The NSE Website and NSE Handbooks 2003 and 2009 Editions

Appendix 2: Non- Financial Public Listed Companies excluded in the sample at the time of carrying out the study

	Commercial and Services	Audit Firm
1	Company 31	A
2	Company 32	A
3	Company 35	D
	Industrial and Allied	
4	Company 33	E
5	Company 34	B
	Alternative Investments Markets Segment (AIMS)	
6	Company 36	A
7	Company 37	D
8	Company 38	F

Source: The NSE Website and NSE Handbooks 2003 and 2009 Editions

Appendix 3: Analysis of variance^b for model 1

Model		Sum of Squares	df	Mean Square	F	Sig.
Model 1	Regression	19.747	8	2.468	49.946	.000 ^a
	Residual	9.933	201	.049		
	Total	29.680	209			

a. Predictors: (Constant), BODS, LEV, INVRECTA, BODE, BODD, FR, BODI, LNTA

b. Dependent Variable: LNFEE

Source: 2003 - 2009 Research data, Researcher's computations

Appendix 4: Pearson correlations coefficients for the variables used in the regression (LNFEE)

		LNFEE	LNTA	FR	INVRECTA	LEV	BODI	BODD	BODE	BODS
LNFEE	Pearson Correlation	1								
	Sig. (2-tailed)									
	N	210								
LNTA	Pearson Correlation	.764**	1							
	Sig. (2-tailed)	.000								
	N	210	210							
FR	Pearson Correlation	-.145*	-.200*	1						
	Sig. (2-tailed)	.036	.004							
	N	210	210	210						
INVRECTA	Pearson Correlation	-.070	-.181**	-.293**	1					
	Sig. (2-tailed)	.311	.009	.000						
	N	210	210	210	210					
LEV	Pearson Correlation	.145*	.235**	.461**	-.010	1				
	Sig. (2-tailed)	.035	.001	.000	.880					
	N	210	210	210	210	210				
BODI	Pearson Correlation	.411**	.369**	-.148*	.069	.194**	1			
	Sig. (2-tailed)	.000	.000	.032	.320	.005				
	N	210	210	210	210	210	210			
BODD	Pearson Correlation	.179**	.293**	-.090	-.078	-.020	.221**	1		
	Sig. (2-tailed)	.009	.000	.196	.258	.770	.001			
	N	210	210	210	210	210	210	210		
BODE	Pearson Correlation	.241**	.102	.045	-.044	.137*	.311**	-.102	1	
	Sig. (2-tailed)	.000	.140	.517	.530	.047	.000	.142		
	N	210	210	210	210	210	210	210	210	
BODS	Pearson Correlation	.566**	.523**	-.121	-.136*	-.021	.441**	.163*	-.047	1
	Sig. (2-tailed)	.000	.000	.079	.049	.762	.000	.018	.497	
	N	210	210	210	210	210	210	210	210	210

Note: **. Correlation is significant at the 0.01 level, *. Correlation is significant at the 0.05 level (2-tailed).

Source: 2003 - 2009 Research data, Researcher's computations

Appendix 5: Corporate governance disclosure score by companies for all years of the study

	Main Investments Market Segment (MIMS)	% of Corporate Governance Disclosure							
		2003	2004	2005	2006	2007	2008	2009	Average %
[A]	Agriculture								
1	Company 1	90	90	90	90	90	90	90	90
2	Company 2	90	90	90	90	90	90	90	90
3	Company 3	60	60	60	60	70	70	70	64
[B]	Commercial and Services								
4	Company 4	100	100	100	100	100	100	100	100
5	Company 5	90	90	90	90	90	90	90	90
6	Company 6	40	50	50	70	80	80	80	64
7	Company 7	40	40	40	40	40	40	40	40
8	Company 8	30	30	30	30	30	30	70	36
9	Company 9	70	70	70	70	80	80	80	74
10	Company 10	70	70	70	70	70	70	70	70
[C]	Industrial and Allied								
11	Company 11	60	60	60	60	70	70	80	66
12	Company 12	80	100	100	100	100	100	100	97
13	Company 13	70	70	70	70	80	80	80	74
14	Company 14	80	80	90	90	100	100	100	91
15	Company 15	60	60	60	60	70	80	70	66
16	Company 16	80	80	80	80	80	80	80	80
17	Company 17	70	70	70	70	70	70	60	67
18	Company 18	80	80	80	80	80	80	80	80
19	Company 19	20	20	30	30	50	70	60	40
20	Company 20	30	30	70	70	80	80	80	63
21	Company 21	80	80	80	80	80	80	80	80
22	Company 22	40	50	50	50	60	90	90	61
23	Company 23	90	60	100	100	100	100	100	93
24	Company 24	80	80	80	90	90	90	90	86
25	Company 25	50	50	50	70	80	90	80	67
[D]	Alternative Investments Markets Segment (AIMS)								
26	Company 26	30	30	20	20	20	20	20	23
27	Company 27	50	50	50	50	60	60	60	54
28	Company 28	50	50	50	50	50	50	50	50
29	Company 29	70	70	70	70	70	70	70	70
30	Company 30	20	20	20	20	20	20	20	20

Source: 2003-2009 Research data, author's computations

Appendix 6: Pearson correlations coefficients for the variables used in the regression (CGDI)

		CGDI	LNTA	LEV	INDU1	INDU2	INDU3	INDU4	BODI	BODD	BODE	BODS
CGDI	Pearson Correlation	1										
	Sig. (2-tailed)											
	N	210										
LNTA	Pearson Correlation	.401**	1									
	Sig. (2-tailed)	.000										
	N	210	210									
LEV	Pearson Correlation	.297*	.250**	1								
	Sig. (2-tailed)	.000	.000									
	N	210	210	210								
IT1	Pearson Correlation	.195**	-.057	.009	1							
	Sig. (2-tailed)	.005	.415	.901								
	N	210	210	210	210							
IT2	Pearson Correlation	.090	.108	.269**	-.231**	1						
	Sig. (2-tailed)	.194	.119	.000	.001							
	N	210	210	210	210	210						
IT3	Pearson Correlation	-.048	.094	-.115	-.333**	-.692**	1					
	Sig. (2-tailed)	.485	.174	.097	.000	.000						
	N	210	210	210	210	210	210					
IT4	Pearson Correlation	-.287**	-.304**	-.267**	-.096	-.199**	-.287**	1				
	Sig. (2-tailed)	.000	.000	.000	.167	.004	.000					
	N	210	210	210	210	210	210	210				
BODI	Pearson Correlation	.455**	.369**	.213**	.118	.098	.161*	-.608**	1			
	Sig. (2-tailed)	.000	.000	.002	.087	.159	.020	.000				
	N	210	210	210	210	210	210	210	210			
BODD	Pearson Correlation	.173*	.293**	-.021	-.079	-.078	.157*	-.068	.221**	1		
	Sig. (2-tailed)	.012	.000	.765	.254	.258	.023	.325	.001			
	N	210	210	210	210	210	210	210	210	210		
BODE	Pearson Correlation	.176*	.089	.135	-.072	-.061	.232**	-.248**	.474**	-.076	1	
	Sig. (2-tailed)	.011	.197	.051	.299	.382	.001	.000	.000	.272		
	N	210	210	210	210	210	210	210	210	210	210	
BODS	Pearson Correlation	.264**	.523**	.023	-.161*	.384**	-.102	-.302**	.441**	.163*	-.018	1
	Sig. (2-tailed)	.000	.000	.736	.019	.000	.140	.000	.000	.018	.795	
	N	210	210	210	210	210	210	210	210	210	210	210

Note: **. Correlation is significant at the 0.01 level, *. Correlation is significant at the 0.05 level (2-tailed).

Source: 2003 - 2009 Research data, Researcher's computations

Appendix 7: Analysis of variance^b for model 2 (Dependent variable – CGDI)

Model		Sum of Squares	df	Mean Square	F	Sig.
Model 2	Regression	3.551	9	.395	11.001	.000 ^a
	Residual	7.174	200	.036		
	Total	10.725	209			

a. Predictors: (Constant), BODS, BODE, LEV, BODD, IT1, IT3, IT4, LNTA, BODI

b. Dependent Variable: CGDI

Source: 2003 - 2009 Research data, Researcher's computations

Appendix 8: Summary of disclosure requirements (Guidelines on Governance Practices by Public Listed Companies in Kenya)
of Gazette Notice No. 3362, 14 May 2002, the Capital Markets Act, 2002

[A]	Principles of good corporate governance practices	Clause
	Directors	2.1
	The board shall specifically establish an audit committee and a nominating committee	2.1.1 (ii)
	The companies should establish a formal and transparent procedure for Directors remuneration, which should be approved by the shareholders	2.1.2
	Supply and disclosure of information – the board should be supplied with relevant, accurate and timely information to enable it discharge its duties	2.1.3
	Board balance – should compose a balance of executive directors and non-executive directors of diverse skills or expertise in order to ensure that no individual or small group of individuals can dominate the board’s decision-making processes	2.1.4
	Appointments to the board – a formal and transparent procedure in the appointment of directors to the board	2.1.5
	Multiple directorships - a person should not hold the position of director of a listed company in more than five public listed companies at any one time to ensure effective participation in the board	2.1.6
	Re-election of directors – existing shareholders required to submit themselves for re-election at regular intervals	2.1.7
	Resignation of directors – should be disclosed in the annual report together with the details of the circumstances necessitating the resignation	2.1.8
	There should be a clear separation of the role and responsibilities of the chairman and chief executive officer	2.2.1
	Shareholders	2.3
	Approval of major decisions by shareholders	2.3.1
	The board should provide to all its shareholders sufficient and timely information concerning the date, location and agenda of the general meeting as well as full and timely information regarding issues to be decided during the general meeting	2.3.2 (i)
	Accountability and Audit	2.4
	The board should ensure that accounts are presented in line with International Accounting Standards	2.4.1
	The board should maintain a sound system of internal control to safeguard the shareholders investments and assets	2.4.2
	The board should establish a formal and transparent arrangement for shareholders to effect the appointment of independent auditors at each annual general meeting	2.4.3
	Relationship with auditors – a formal and transparent arrangement established by the board for maintaining a professional interaction with the company’s auditors	2.4.4
	General	2.5
	Public disclosure – in respect of any management or business agreements entered into between the company and its related companies, which may result in a conflict of interest	2.5.1
	Chief Financial Officers of public listed companies	2.5.2
	Company Secretaries of public listed companies – shall be members of the Institute of Certified Public Secretaries of Kenya	2.5.3
	Auditors of public listed companies - shall be members of the Institute of Certified Public Accountants of Kenya and shall comply with the International Auditing Standards	2.5.4
[B]	Recommended best practices in corporate governance (by public listed companies)	3
	Best practice relating to the board of directors	3.1
	The role and responsibilities of the board of directors – should assume a primary responsibility of fostering the long-term business of the company with their fiduciary responsibility to the shareholders	3.1.1
	The board of every listed company should reflect a balance between independent, non-executive directors and executive directors	3.1.2 (i)
	Appointment and qualifications of directors	3.1.3
	Remuneration of the directors – disclosing in the annual report (a) total remuneration for executive directors (b) total fees for non-executive and independent directors	3.1.4 (iv)
	Best practices relating to the position of Chairman and Chief Executive	3.2
	As a matter of best practice the role of the chairman and chief executive should be separate in order to ensure a balance of power and authority and provide for checks and balances	3.2 (i)
	Best practices relating to the rights of the Shareholders	3.3
	As a matter of best practice, all shareholders should receive relevant information on the company’s performance through distribution of regular annual reports and accounts, half-yearly results and quarterly results.	3.3 (ii)
	Best practices relating to the conduct at general meetings	3.4
	Best practices relating to accountability and the role of Audit Committees	3.5
	The Audit Committee	3.5.1
	Attributes of Audit Committee members	3.5.2
	Duties of Audit Committees	3.5.3
	Audit Committees and internal audit functions	3.5.4
	Participation in the meetings of Audit Committees	3.5.5

Source: The Capital Markets Act, Chapter 485A, 2002, Gazette notice no. 3362

Appendix 9: Summary of the requirements of the Sixth Schedule to the Kenya Companies Act and Sections 197 and 198 of the Act

[A]	Balance Sheet	Paragraph
	The following items must be shown:	
	Share Capital	
	Authorized Share Capital	2
	Issued Share Capital	2
	Redeemable Preference Shares and earliest date when they can be redeemed	2(a)
	Share Premium	2(c)
	Total Capital (non-distributable) Reserves and a schedule of year's movements	6 7
	Dividend proposed	8(e)
	Total Revenue (distributable) Reserves and a schedule of movements for the year	6 7
	Any debentures redeemed which the company can reissue	2(d)
	Property, plant and equipment (fixed assets)	
	<i>Cost or valuation</i>	
	Total for each class of asset and overall total	5(1)(a) 5(3)(a)
	<i>Accumulated depreciation since purchase or valuation</i>	
	Total for each class of asset and overall total	5(1)(b) 5(3)(b)
	<i>Net book value for each class of asset and overall total</i>	4(3) 4(1)
	Goodwill: net book value	8(1)(b)
	Patents and trade marks	8(1)(b)
	Investments	
	Total of trade investments	8(1)(a)
	Investments other than trade	
	Total of quoted and market value	8(1)(a) 11 (8)
	Total of unquoted	8(1)(a)
	Total of loans to any officers of the company	s. 198
	Total of loans to employees to buy shares in the company	8(1)(c)
	Total of current assets	4(1)
	Aggregate amount of bank loans and overdraft	8(d)
	Tax liability to balance sheet date and basis of computation	11(10)
	Total of current liabilities	4(1)
	Comparative amounts for each item as at the end of the preceding year	11(11)
	Disclose at least by way of note:	
	Where any liability is secured, the fact that the liability is secured	9
	The number, description and amount of any shares in the company which any person has an option to subscribe for and the period during which it is exercisable and the price to be paid for the shares	11(2)
	The amount of any arrears of fixed cumulative dividends & the period for which they are in arrears	11(3)
	Particulars of any charge on the assets of the company to secure the liabilities of any other person and the amount secured	11(4)
	The general nature of any contingent liabilities and the estimated amount of those liabilities	11(5)
	The aggregate amount of contracts for capital expenditure which have not been provided for	11(6)
	The bases for which items denominated in foreign currencies are converted to Kenya currency	11(9)

Source: The Companies Act, Chapter 486, Laws of Kenya, 1962

Appendix 9 (continued): Summary of the requirements of the Sixth Schedule to the Kenya Companies Act and Sections 197 and 198 of the Act

[B]	Profit and Loss Account:	Paragraph
	The following items must be shown:	
	Income from investments: Trade	12(1)(g)
	Other than trade	12(1)(g)
	Depreciation charge for the year	12(1)(a)
	Interest on debentures and fixed loans	12(1)(b)
	Auditors' remuneration (including expenses)	13
	<i>Directors' remuneration</i>	
	For services as management	s. 197(2)(a)
	For services as directors	s. 197(2)(b)
	Subtotal	s. 197 (1)(a)
	<i>Pension contributions for directors</i>	
	For services as management	s. 197(3)(a)
	For services as directors	s. 197(3)(b)
	Subtotal	s. 197(1)(b)
	<i>Directors' compensation for loss of office</i>	
	For services as management	s. 197(4)(a)
	For services as directors	s. 197 (4)(b)
	Subtotal	s. 197(1)(c)
	Income tax charge for the year	12(1)(c)
	Aggregate amount of dividends paid and proposed	12(1)(h)
	Provisions for redemption of share capital and/or debentures	12(1)(d)
	Transfers to/from reserves	12(1)(e)
	Comparative amounts for each item for the preceding year	14(5)14(5)
	Disclose at least by way of note:	
	The basis on which the amount payable for tax is computed	14(3)
	Whether the dividend paid and proposed is subject to income tax	14(4)
	Any exceptional items	14(6)(a)
	Any changes in the basis of accounting	14(6)(b)

Source: The Companies Act, Chapter 486, Laws of Kenya, 1962