A SURVEY OF THE OPINIONS OF MANAGEMENT AND EXTERNAL AUDITORS OF PUBLICLY QUOTED COMPANIES ON THE NEED FOR A CORPORATE GOVERNANCE AUDIT IN KENYA

BY

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DECLARATION

I confirm that this research paper is my original work and I am not aware of any similar work having been done in any university.

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Dated this 22 day of October 2002.

This research paper has been submitted to the university with my approval as an authorized University of Nairobi supervisor.

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Dated this 23rd day of October 2002.

DEDICATION

I dedicate this work first to God, to my parents, my wife and child. They all have been very inspirational in my efforts so seek knowledge and to excel in all what I do in life.

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ABSTRACT

This research was carried out to examine whether or not there is a need for a corporate governance audit in Kenyan publicly quoted companies. The motivation to carry out the research was as a result of the increasing dominance of corporate governance issues both in the local and international financial press. The debate has had increasing popularity due to recurring management ineptness and lack of accountability leading to the collapse of various organisations. Faced by these collapses, communities around the world have mounted a search for good governance in an effort to combat business failures and ensure responsible company governance but little success, if any, appears to have been achieved given the increasingly high number of business failures over the last few years.

The research used predesigned questionnaires to collect information relating to the need for such an audit. From the two categories of the selected research respondents (chief executive officers of publicly quoted companies and external auditors of the publicly quoted companies) the research findings indicates that there is a need for a corporate governance audit in Kenyan publicly quoted companies. Also, the research went further to obtain the respondents' suggestions on who might be more preferred to carry out the audit. External auditors were voted to be the most preferred candidates in carrying out such an audit. The other popularly suggested names included the Private Sector Corporate Governance Trust, independent management consultancy firms, audit committees and internal auditors. It is, therefore, imperative that the suggested names would need to consider expanding their current services so as to include some aspects of a corporate governance audit. This obviously calls for an improvement in their service

delivery processes and infrastructures so as to ensure that they can be able to competently offer the additional service.

The research findings provides a new useful dimension on how to improve corporate accountability as well as providing suggestions on who might be more preferred to carry out the audit. It also serves as an early warning to the suggested corporate governance auditors and all the other corporate governance stakeholders to evaluate their future business direction. It is hoped that the research findings will go along way in provoking further research and discussions in this direction which would result into the long awaited solutions to corporate failure.

CHAPTER ONE-INTRODUCTION

1.1 OVERVIEW OF CORPORATE GOVERNANCE

Societies the world over have become increasingly concerned by the way in which businesses are governed because of the realisation that business decisions affect (to a large extent) the communities within which they operate. Communities have, therefore, realised that they have some rights in knowing how these businesses are run. Today's interdependency between the society and businesses demand that companies be accountable to the society because of the far-reaching effects of company decisions. When companies fail to exercise accountability towards the society, they inevitably jeopardize their very own existence because it is the society, which has given the companies a mandate to exist. Frequently, companies have become pariah and have closed business following conflicts between company objectives and societal desires. It follows, therefore, that communities shall continually call upon companies to adapt practices that reinforce mutual coexistence with the society they operate in (Newman, Lorgan and Hegarty, 1989; Longenecker and Pringle, 1981).

Despite the continuing search for good governance, few communities have been successful in ensuring responsible company practices. Fraud, mismanagement, high level scandals and misappropriation of company funds among other irregularities have become the order of the day. This has had to spark renewed calls for the society to demand good governance from companies. These demands are based on the conventional wisdom that poor governance and company profitability are inversely related. This means that good governance will almost translate to the company's long-term existence and its continued generation of profits and services among other related benefits that may accrue to the immediate society. Because of this reasoning, societies are pushing for more responsible and accountable company activities all in the name of corporate governance. Corporate governance has, therefore, become an important concept in this fight against irresponsible company behaviour because such behaviour often leads to collapse of businesses (Stiles, 1993, Patton and Backer 1987; Newman, Lorgan and Hegarty 1989; Stiles and Taylor, 1993; Demb and Neubauer, 1992).

Corporate governance is a concept, which is concerned with how organisations are run. It primarily aims at influencing the means through which management would realise the laid down company objectives. These means must be appropriate and rewarding to both the company and the immediate community and stakeholders. Good governance leads to responsible decision making reflecting the wishes and desires of the company's stakeholders. Examples of such stakeholders include suppliers, employees, the public, customers and above all, the shareholders of the company. Since these stakeholders are central to the operation of the company, they would ordinarily require that management run the business in such a manner that their welfare is taken care of. Corporate governance, therefore, ensures management accountability to these stakeholders. Long-term company competitiveness and respect for the wishes and desires of company stakeholders is attributable to good governance. Good governance, therefore, reflects the insistence on responsible corporate activities by holding management accountable for the decisions they make. Corporate governance nurtures all progressive traits while discouraging irregularities within companies (Stiles and Taylor, 1993).

For many decades now, the search for responsible company practices has become a major characteristic for many companies. For the last three decades now, this search has become a major topic of concern because of several reasons. One reason is because of the business failures, which have occurred in the absence of any warning from any direction. Cases of business failures such as the Maxwell Corporation, the Bank of Credit and Commerce International (BCCI), the Barings Bank, Polypeck, Enron and Worldcom corporations have left the society greatly amazed because their fall was not preceded by any warnings and their managers were known to be the experts of the day. Stiles (1993) explain that the spectacular company collapse today, is as a result of lack of preventive measures within corporate control.

Another reason for the significant coverage of corporate governance matters in the recent times is because of the corporate weaknesses which have been exposed by the hard economic times all over the world. Stiles (1993) observes in his article 'The future of the board: Self regulation or regulation,' that issues of corporate governance are currently being emphasized due to the hard economic times, which have exposed certain corporate weaknesses. The volatility of the world economy has significantly increased the risks faced by companies today. Stiles concludes that in such a non-compromising environment, we can no longer afford to overlook corporate fraud, mismanagement and unjustified executive pay awards among other irregularities (Demb and Neubauer, 1993; Dimsdale and Prevezer, 1994).

Also, corporate governance matters have become a major topic of concern because of the interdependency between the corporate sector and the society. Apart from the jobs, essential services and goods that companies provide, companies have also been involved in community based activities which have made them to become essential development partners with the society. Corporate activities are being questioned because of the realisation that our societies are becoming increasingly dependent on decisions made by companies especially the large corporations. Drucker (1974) says that society will scrutinise company activities and especially those of large and visible businesses so as to ensure accountability. Because of the above three reasons, corporate governance shall continue to get the attention of scholars, managers and the public as a whole (Dimsdale and Prevezer, 1994; Salmon, 1995; Kiggundu, 1989).

1.2 MANAGEMENT

For purposes of this study, the term management is used to mean the board of directors (and hence the two terms are used interchangeably), which is the team appointed by the shareholders to run the business on their behalf (the shareholders). This group is expected to exercise good governance and report periodically to the shareholders on their stewardship. Indeed, the controversy on the role of the board of directors exists simply because of the separation between the shareholders and the directors and hence the agency problem. Corporate governance has been suggested as one way in, which the agency problem between the shareholders and the board can be managed.

Because of the important role played by the board of directors in corporate governance, it is important to have an overview of the composition of various boards of directors before designing an appropriate monitoring agency. Many boards are made up of twelve to twenty-five members. Small companies, however, have fewer members. The board is made up of executive and non-executive directors. The executive directors are members of the management team and the non-executive directors are drawn from other sources such as large stockholders, bankers, suppliers, customers, lawyers and representatives of certain professional bodies.

Stewardship requires that the agent provide the principal with a status report on how well the stewardship has been executed. Boards of directors would thus need to furnish the company stakeholders with a corporate governance report on the business they have been entrusted with. The big question has been whether the directors would be objective enough when reporting on themselves. Njoroge (1993) points out that there is normally a problem in conveying the truth when the reporter and the recorder of an activity are one and the same person because one reports what s/he sees, which is influenced by what one expects. She concludes that the auditor, representing the views of the shareholders rather than those of the management, acts as an umpire of fairness of what is recorded and reported by management.

Apart from the expected reporting bias on the part of the board of directors, it has been noted that boards of directors are highly fallible; "managers are prone to malpractice" and have over the years been characterized by mismanagement and high level of fraud and scandals. As a result of this, it has increasingly become difficult to trust the directors to objectively report on their stewardship in managing the resources entrusted to them. In the absence of such an objective management stewardship report, this research was thus carried out to establish whether in the first instance such a report would be desirable at least from the point of view of organisations quoted at the Nairobi Stock exchange. If desirable, the research also went further ahead to obtain the respondents' views on who might be better suited to carry out the audit.

1.3 STATEMENT OF THE PROBLEM

There is overwhelming evidence that boards of directors are the major cause of corporate failure and this ineffectiveness has, for example, caused the loss of the world market by companies in the United States of America. Dun and Bradstreet Inc (1973), for example, assigns 94.6% of business failures to management incompetence and fraud.

Even though institutional investors have been known to be powerful in influencing corporate decisions by virtue of their large shareholding, these have not been successful in ensuring acceptable corporate governance practices in modern businesses. This has been the case because the shareholders are in most cases divorced from the day to day running of the business and there has been no shareholder appointed agent who can objectively report to the shareholders on the organisation’s corporate governance practices.

The other suggested remedy to the shareholders’ funds has been the judiciary but this has also been proved to be ineffective because it acts from outside the company (hence lacks complete information about the company) and also starts the intervention process when it is rather too late. It is on the basis of such inadequacies in the control, monitoring and intervention procedures that this research sought to establish whether or not a shareholder commissioned corporate governance audit would be desirable, particularly for publicly quoted companies who bear a larger proposition of the agency problem in the corporate sector.

1.4 OBJECTIVES OF THE STUDY

The objectives of the study were as follows:

1. To establish whether or not there is a need for a corporate governance audit from the viewpoint of management and external auditors of publicly quoted companies in Kenya.
2. To identify who might be the most preferred candidate to carry out a corporate governance audit.

1.5 IMPORTANCE OF THE STUDY

This study, which is the first of its kind in Kenya, is expected to be of interest to the following groups of people:

1. Management- the research provided management with an opportunity to air their views on the required control mechanisms so as to provide the shareholders with more assurance on management's credibility and stewardship. Enhanced management credibility is essential to boost shareholder confidence, which would in turn be beneficial to management's existence.
2. Shareholders- the research findings provides the shareholders with management and external auditors' input on what may need to be done in future so as to ensure the security of their funds. This forms a basis of further shareholder discussions and a sensitization campaign so as to ensure that such proposals are included in the country's future legislation.
3. The Institute of Certified Public Accountants of Kenya-The study provides a basis for further discussion by the institute on the possibilities of extending the work of their members to include a corporate governance audit.
4. Others-Included in this category are academicians, creditors, governments, and any other parties who may be interested in the credibility of management.

1.6 SCOPE OF THE STUDY

The study investigates whether or not there is a need for a corporate governance audit in Kenya. The research was cross-sectional and the views collected were at one particular point in time. The respondents were management and the external auditors of publicly quoted companies in Kenya. These respondents were considered to be well placed to comment on matters of possible controls and monitoring procedures on corporate governance matters by virtue of their experience in their organizations. Their views could thus be representative of the overall Kenyan corporate sector by virtue of the place the stock exchange occupies in any economy.

It might have been worthwhile to also collect shareholders' opinions on this matter but this was not possible because of the diversity of shareholders of publicly quoted companies in Kenya and the time limitation of the study. The study, however, assumes that shareholders' views are to a large extent represented by the two selected groups of respondents. This is partly because many management teams have ownership interests in the organizations they run and/or other organizations and hence apart from them commenting on the subject as though they were managers only, their opinions are definitely influenced by their shareholding in the various organizations. The external auditors of the publicly quoted companies are also expected to be very resourceful persons on matters relating to the appropriate control mechanisms to protect the interests of the stockholders. Their interaction with the shareholders and their confirmed reputation to audit perhaps the most delicate organizations in the economy gives them the ability to knowledgeably comment on behalf of the shareholders and themselves.

CHAPTER TWO-LITERATURE REVIEW

2.1 CORPORATE GOVERNANCE

Corporate entities have continued to be indispensable partners in development and also a backbone to sustainable economic growth in the whole world. Over time, there has been some apparent dependence of society on company activities and this phenomenon has necessitated company behavior to be monitored in an effort to ensure the continued company performance and contribution to economic development (Kiggundu, 1989; Drucker, 1974).

Because of the above, communities will continue to closely monitor company activities and especially those companies that appear to make significant economic contribution to the society. This scrutiny shall aim to ensure that these companies are well. It is on the basis of this concept that corporate governance has emerged. Its development has to a great extent been triggered by an overwhelming negligence on the part of company officers. Corporate governance has come into existence because the society has suffered greatly because of irresponsible company behavior. Corporate governance, therefore, aims to curb this irresponsibility in company behavior through various governance channels (Newman, Lorgan and Hegarty, 1989; Stiles, 1993).

2.1.1 DEFINITION OF CORPORATE GOVERNANCE

Demb and Neubauer (1992) define corporate governance as the process by which corporations are made responsible to the rights and wishes of stakeholders. Stiles and Taylor (1993) have also defined corporate governance as the means through which companies are influenced to respond to societies' interests and desires. In some way, corporate governance has been associated with the separation of company shareholders and its directors (management). Good governance requires management accountability to the shareholders. Corporate governance calls upon the directors to act responsibly and in the best interest of the shareholders. This is because corporation governance provides an interface between the shareholders who are the principals on one hand and the management who are the agents on the other hand (Newman, Lorgan and Hergarty, 1989; Melvin, 1986; Blair, 1993; Roe, 1994).

Corporate governance, however, does not provide a solution to all the controversies and issues between the directors and the shareholders. It goes beyond the short-term profit concerns to issues of company behavior and social responsibility. Because of this, corporate governance entails the need to pressure directors to act responsibly and in the best interest of the shareholders and the interacting community (Salmon, 1995; Stiles and Taylor, 1993; Longenecker and Pringle, 1981).

2.1.2 A BRIEF BACKGROUND OF CORPORATE GOVERNANCE

Corporate governance is not a new phenomenon in the world today. It relates to accountability, which every society has had over the years. Longenecker and Pringle (1981) have, for example, documented corporate governance issues in the 1970s. They explain that corporate governance issues arose in these years because these years were characterized by an increase in major business scandals in the United States of America. The immediate action taken against these practices was the demand that top management shows accountability and prudence in the allocation of company resources (Demb and Neubauer, 1993; Longenecker and Pringle, 1981).

At about the same time, Drucker (1974) was greatly alarmed by the frequency with which top management lacked accountability. Drucker called upon company directors to monitor and supervise the other company officers. This he said would ensure good governance and in turn bring reasonable returns on investments for the shareholders. Drucker, just like many other writers such as Patton and Baker, 1987; Andrews, 1981 and Melvin, 1986 was concerned with the directors' responsibility to provide good governance.

2.1.3 RECENT CORPORATE GOVERNANCE TRENDS

Even though the concept of corporate governance has not changed much, issues of governance have continued to take major attention in our media today and even with more intensity. Corporate governance as of today is a major topic in every organ of management and also in the media all over the world. Some writers who have documented this recent phenomenon include Demb and Neubauer (1992) and Dimsdale and Prevezer (1994).

Despite the major debate on how organizations can be run, corporate governance has not been successful in ensuring that directors act in a responsible manner. Many firms have not been able to operate optimally because of failure to use or misuse of company resources. Drucker (1974) and Stiles and Taylor (1993) confirm that top management has proved to be highly fallible; "managers are ever prone to malpractice". Stiles (1993) has also documented high profile scandals leading to company collapses such as the case of BCCI and the Maxwell Corporation, unjustified executive pay awards which are inversely related to company performance and cover-ups resulting from creative accounting. Worldwide economic hard times together with intense competition and scarcity of resources have aggravated the quality of business management and this has catalyzed intensive debate on how this malpractice can be avoided or minimized. Corporate governance has been suggested to be the cure-it-all but unfortunately, the monitoring and control aspects have not been adequately addressed.

Corporate governance has, for example, been emphasized in Britain because of the declining competitiveness of British companies especially as compared to those in Japan, Germany and the newly industrialized countries. This emphasis has led to the formation of the Cadbury committee whose recommendations have been widely adopted. The United States of America has also followed suit in these endeavors particularly after Japan's spectacular economic breakthrough. The outcome of all these has been an extensive discussion on corporate governance (Salmon, 1995; Prevezer and Dimsdale, 1994).

It has increasingly become clear that developing countries should not lag behind in discussing and documenting corporate governance matters. The developed world has already shown the lead way in this area, which can form a blue print on the way forward for developing nations. Kiggundu (1989) cites the worrying recurrence of improper allocation of company resources, and the eventual collapse of companies in developing nations as a pointer to the failure in corporate governance.

2.1.4 CORPORATE GOVERNANCE CHANNELS

Stiles and Taylor (1993) define corporate governance channels as the various agents of governance such as shareholders, legislative codes, regulatory mechanisms and the board of directors, which the society has developed over the years in order to ensure that corporations are run according to the expectations of the shareholders. The purpose of these channels is to influence business management practices in the various firms, which they are involved in (Stiles and Taylor, 1993; Stiles, 1993; Demb and Neubauer, 1992).

In order to obtain an understanding of the roles of each of these channels, an overview of each channel is found in the foregoing.

2.1.4.1 THE BOARD OF DIRECTORS

For purposes of this study, the term management is used to mean the board of directors (and hence the two terms are used interchangeably), which is the team appointed by the shareholders to run the business on their behalf (the shareholders). This is the major group that is expected to exercise good governance and report periodically to the shareholders on their stewardship. Indeed, the controversy on the role of the board of directors exists simply because of the separation between the shareholders and the directors and hence the agency problem. Corporate governance has been suggested as one way in which the agency problem between the shareholders and the board can be managed.

Because of the important role played by the board of directors in corporate governance, it is important to have an overview of its composition before designing an appropriate monitoring agency. Many boards are made up of twelve to twenty-five members. Small companies, however, have fewer members. The board is made up of executives and non-executive directors. The executive directors are members of the management team and the non-executive directors are drawn from other sources such as large stockholders, bankers, suppliers, customers, lawyers and representatives of certain professional bodies.

Available literature indicates that boards of directors are the major cause of corporate failure despite the fact that they are expected to be the custodians of shareholders' resources. Dun and Bradstreet Inc (1973) assigns 94.6% of business failures to management incompetence and fraud. Some writers who have expressed serious doubts on the integrity of the board of directors include Patton and Backer (1987), Salmon (1995), Drucker (1974), Melvin (1986), Andrews (1981), Stiles and Taylor (1993) and Stiles (1993). A stile (1993), for example, comments on high profile scandals leading to company collapses (the likes of BCCI and the Maxwell Corporation). These writers argue that this board ineffectiveness has caused the loss of world market by companies in the United States. Even though contemporary writers such as Stiles and Taylor (1993), Demb and Neubauer (1993), Lorsch (1995) and Stiles (1993) have argued that the board of directors is a crucial place to start with in corporate governance matters, writers such as Wambua (1999) have strongly contended that accountability requires some agent to monitor management performance because of significant weaknesses which have been noted in boards of directors.

2.1.4.2 THE SHAREHOLDERS

Shareholders and especially institutional investors comprise of a substantial block of capital within the company, which gives them justification for representation in the board of directors, which in turn provides them with considerable influence on the company's decision making process. Shareholders are, therefore, very instrumental in matters of corporate governance. Roe

(1994) says that institutional investors demand to be informed of company activities beforehand but the big question is on who is credible enough to objectively report to the shareholders on any malpractice done by the directors. Institutional investors such as pension funds and insurance firms are lately acting unanimously to dislodge incompetent and fraudulent management teams. This reflects their desire to ensure good governance. Their efforts would thus need to be complemented by someone who has some privileged information on the day to day running of the business, otherwise, the shareholders in most cases have no methods of monitoring management's inefficiency. This is because they are ordinarily divorced from the day to day management of the business. They thus continue to incur certain opportunity losses without their knowledge (Dimsdale and Prevezer, 1994; Blair, 1993; Roe, 1994).

Wambua (1999) has on the other hand observed that individual shareholders (also called private shareholders) lack clout to make significant impact on corporate governance. This is because this category of investors lack interest to directly influence company course. This indifference results from two main reasons. One of the reasons is that capital markets have produced a breed of investors who are more concerned with short-term benefits as opposed to long-term company concerns. In this case, they would rather dispose off their shares in a poorly performing company, than go for the usually lengthy and strenuous task of dislodging its management team. Secondly, this hands-off attitude has been attributed to the fact that shareholders are too diffuse to jointly pool their weight and influence the management team.

2.1.4.3 LEGISLATIVE CODES AND REGULATORY MECHANISMS

Legislative codes contribute to corporate governance because they are tailored to contain company exesses and they also ensure responsible company behavior. They are a common phenomenon in every society today and examples of such include rights of shareholders and various ways to seek redress in courts of law. The regulatory mechanisms include antitrust laws, employment conditions and toxic waste disposal all which prevent management from acting irresponsibly.

Salmon (1995), however, points out that all these channels of corporate governance have significant weaknesses because they depend on the judicial system and they also act from outside the company. They usually try to contain company malpractice when it has escalated to unmanageable levels. This is so because they often lack detailed information about the particular companies.

2.2 THE PLACE OF AN AUDIT

Numerous proposals have been made for extending the scope of audit practice. There has been proposals to extend the scope to other types of published financial accounting information and to historical financial accounting information that is now published. There have also been proposals to extend the scope to non-historical financial accounting information and to non-financial information.

Proponents of these proposals argue that historical-cost based financial statements represent just a part of the information that is required by users for decision-making purposes. Proponents of this school of thought argue that since the additional information is needed, it should be disclosed to the users and the reliability of such information would be enhanced if it were reviewed by an independent competent third party.

The American Accounting Association (1972) in its Report of the Committee on Basic Auditing Concepts have defined auditing as a systematic process of objectively obtaining and evaluating evidence regarding assertions about economic actions and events to ascertain the degree of correspondence between these assertions and established criteria and communicating the results to interested users. This definition appears to suggest that an audit should not be restricted to financial statements. The definition is broad enough that while it conveys the basic idea that an audit is an investigative process, it is sufficiently comprehensive to encompass the many different purposes for which an audit may be conducted and the variety of the subject matter that may be focussed on in a specific audit engagement. If these arguments are valid, it is, therefore, possible that the auditing function can be gradually extended to new types of information such as a corporate governance audit.

2.3 THE NEED FOR A CORPORATE GOVERNANCE AUDIT

The presentations so far made have tried to offer a theoretical support to the objectives of the study. This sort of study has not yet been carried out in Kenya and the researcher is also not aware of any similar surveys done elsewhere in the world. The only similar studies done are in the area of management audits but these cannot be strictly equated to a corporate governance audit because the theoretical concept of management audits have not been supported by an established basis for such an audit which is generally acceptable to all. Corporate governance on the other hand is a growing area of concern and certain guidelines have already been put forward by authoritative bodies such as the Private Sector Corporate Governance Trust and the Capital Market Authority. These developments are suggestive that organizational governance is a major area of concern in the business fraternity and the next possible area of concern is on how shareholders will be assured that the directors have adhered to the so called corporate governance practices should they be made law. The field of management audit has not been popular because it has not been definitive in terms of the desired results and the fact that it has not been supported by an established body of knowledge and practice as is the case for corporate governance. A corporate governance audit will thus be an extension of the management audit theory, where a basis of audit can be established using the current body of knowledge such as the code of best practice among others.

There is only one local survey, which has been found on management audit, and this was done by Kinandu Murage in 1981. Murage found out that there was no established basis to be used in determining the scope of management audit and respondents were rather reserved on who should do such an audit notwithstanding the fact that they found the idea quite interesting. Some other surveys done elsewhere on management audit include one by Smith et al (1972) who found out that the need for a management audit existed but they were not conclusive on the issue of the scope. Santock (1974) found out that the concept of management audit was loose and imprecise in both theory and practice and the many firms he surveyed took a reserved position on the subject.

Even though most of the theory shows that a corporate governance audit would be subjective in nature, there is no fear that some important and useful results can be achieved in this survey. This is because audits are by their very nature subjective because they entail some evaluation and expression of an opinion. The determination of the fairness of financial statements in the financial audit is an example of some of the subjective considerations of an audit.

The major reasons why a corporate governance audit is of great importance is because of the importance of the role of management together with the expectations of the shareholders who have entrusted their resources to management. Newman and Logan (1976) says that management's role in a business has been and will continue to be that of the control agent. Their task is to establish the environment for group effort in such a way that individuals will contribute to group objectives. As control agents, management must plan, organize and control operations of the organizations for and on behalf of those having an interest in the organizations. The Chief executive officer has been delegated authority from the shareholders, the board of directors, the public, government bodies and certain other regulatory agencies.

Management has been delegated authority and entrusted with scarce company resources. As a result of this, it can be argued that a report must be made (which could be referred to as a corporate governance report) to the interested parties as to the effectiveness and efficiency of management in performing their duties. Braden (1968) and Ravenhill (1968) says that an audit of management is necessary because it protects shareholders' interests. A corporate governance audit would subject management to fear of public criticism, which would compel management to use proper methods in deciding on new investments, to be more energetic in finding new profitable investments, to devote the proper amount of time and effort to ensure continued growth and even greater efficiency in the business. A corporate governance audit would also serve as a social function where the auditor reports on the good citizenship of the company.

Ravenhill (1968) says that an increase in the number of shareholders in most public companies and the fact that there is no dominant shareholder who is virtually interested in the progress of the companies, an audit of management might be important in the interest of the shareholders. He also argues that the management audit should not be confined to the actions of the directors and senior executive but also to the junior members of management as well.

Justification for a corporate governance audit could also be argued on the basis of the importance of management as a resource. Businesses attribute most of its successes to their vast reservoir of professional managers, and are quick to identify the lack thereof as one of the barriers to success. If management is such an important resource, and if it is in the interest of shareholders (and the rest of the society for that matter) that a particular organization can survive and grow, then it seems reasonable to conclude that those interested parties would be as interested in information concerning management conditions as in financial condition and other indicators of ability to survive and grow. This idea is supported separately by Mautz (1973) and Beck (1973).

Mautz found out that managerial ability was identified by analysts as the second most important company characteristic (out of a total of six) about which relevant information is desired. Beck carried out a study on the role of the auditor in modern society and found out that the respondents expected the auditor to make subjective assessments about the way management runs the company and about the managerial actions of individuals in the company. Beck bluntly concludes that in the light of such society expectations, a report on the truth and fairness of the balance sheet and the profit and loss statement appears to be quite an inadequate performance of the ascribed role of the company auditor.

From the above literature review, it is clearly evident that organizations will very much depend on management's ability and effectiveness to survive and grow. Where such management is ineffective, the organization faces the danger of failure. It is on the basis of this premise that this study proposed a corporate governance audit which will make management to examine and execute its policies with uttermost care to avoid possible embarrassment.

Studies in corporate failure support the argument that management is the cornerstone of the organization. Studies by Dun and Bradstreet (1973), for example, assign 94.6% of the business failures on management incompetence and fraud. Other studies such as the one by Dewing (1953) generalize failure into several categories but still come up with failure caused by management incompetence at a high level of 60%. Peterson (1980) also provides his personal experience on why management is the major cause of failure of corporations.

This means that despite the many hullabaloos on the importance of corporate governance, management cannot be trusted to objectively report on their compliance to corporate governance because they are prone to malpractice and they have been identified as the major cause of business failures time and again. A financial audit and the resulting report does not tell the complete story on business management. Even though this assessment has never been denied, a corporate governance audit has never been undertaken under whatsoever title (such as an audit of management or otherwise) known to the researcher. Such an audit report will help and facilitate the prediction of the future by decision-makers when used together with the other financial position statements. It would, therefore, be logical to conclude that if there is a need for corporate governance, then people should support the idea of a corporate governance audit because it would be furthering their earlier desires.

2.4 WHO WOULD BE THE MOST PREFERRED CANDIDATE TO CARRY OUT SUCH AN AUDIT

On determining who might be most preferred candidate to carry out the above audit, it may be useful to examine literature on the current financial audit practices and where possible consider the suitability or otherwise for the external auditor to be involved in a corporate governance audit.

A corporate governance audit can be interpreted as a logical extension of the current audit function. The external auditor currently fulfills the need for stewardship accounting. The external auditor also attests information, which has an orientation towards disclosure for decision-making purposes. The audit function has never remained static in nature and an evolution from stewardship to full disclosure is evident. A corporate governance audit, therefore, would be just a little bit extension of the current audit practice. Morse (1971) said that the term ‘performance auditing’ suggested that the full range of management’s responsibilities are within the auditor’s purview. This brings the further extension of his evaluations to the accomplishments of the organization or the effectiveness of its operations in achieving established or prescribed goals or objectives.

The external auditors enjoy professional recognition in society today. Their competence and independence are invaluable in the process of closing the credibility gap between a business organization and the interested parties. Knoll (1976) studied society's expectation on the auditor and the use of auditor's report on individual investors. He came to a conclusion that due to the vast developments in the contemporary world, there had been an increasing number of financial information and an increasing demand and expectation from the auditor. The public was found to have more faith in the ability and integrity of the external auditor and expected that his functions would be widened as well as his capabilities. This would benefit not only management and shareholders, but also the public in general. This is because the audit report has been designed to impart credibility to the statements, which have been prepared by management for use by various third parties.

As part of the financial audit, the external auditor is also required to evaluate a firm's internal control system; and a corporate governance audit would involve, to a great extent, a similar evaluation. Also, since the external auditor conducts a financial audit for a firm, this renders useless the involvement of other professionals.

There are, however, those who have argued that the external auditor requires more training or is in fact not qualified to do an audit of management. Braden (1968) says that the practising accountant is concerned in his day to day work with checking the accuracy of the past. He further points out that the main purpose of management is planning for the future and the best basis of judgment is the success or otherwise of such planning. He concludes by saying that the practising accountants at present are not, by the very nature of their training, attitudes and frame of mind likely to be able to judge.

Such arguments have, however, been refuted by several authors. A survey of investor attitudes indicates that investors still lay much weight on the auditor's report before they make investment decisions. Morison (1971) argues that the audit report impart trust to the investors hence leading to the decision to invest in a company or not. Trust he argues is a prerequisite to investment and if so, the external auditor's report becomes a vehicle to this end. This, therefore, means that even though the auditor's report is backward looking, investors view it as a significant tool of predicting the future. Other more recent researchers such as Hay (1978), Njoroge (1993) and Ball et al (1979) have found out that investors view the auditor's report with some seriousness before making their investment decisions. Further, the time requirements of others to do the work, requiring them to review the systems and to learn about the organization will be too much at very high costs. Work done by others, who will be reviewing the system will be a repetition and, therefore, a waste of effort on what the external auditors would have to do.

CHAPTER THREE-RESEARCH METHODOLOGY

3.1 POPULATION OF STUDY

The study was cross-sectional and took the form of a survey. It targeted the fifty-two publicly quoted companies and their respective external auditors at a particular point in time. A longitudinal survey would have been possibly more desirable but this is not feasible for this study because of shortage of time and other resource limitations.

3.2 SAMPLING

As mentioned earlier in chapter one, the objective of the study was to solicit the views of management and external auditors of publicly quoted companies in Kenya on whether or not there is a need for an independent corporate governance audit. The sample of the study was the external auditors and managements of publicly quoted companies whose managements and/or head offices are situated in Nairobi. A review of the various companies' annual reports (found at Nairobi stock exchange) as at 31 December 2001 showed that the respondents based in Nairobi were adequate to represent the views of the whole population since the sample comprised at least 80% of the total population. A detailed list of the publicly quoted companies and the external auditors involved in the financial audit of these companies is attached on appendix C.

	Publicly quoted companies in Nairobi Stock Exchange as at 31 December 2001	External auditors of the publicly quoted companies
Size of the population in numbers	52	8
Size of the selected sample in numbers	42	7
% of the selected sample	80.7%	87.5%

Since the stock exchange comprises those companies that are truly publicly owned (and have also met certain rigorous listing criteria in order to be quoted at the stock exchange), the results of this study could be taken to represent the general views of the Kenyan corporate sector. Public ownership is a central point in the corporate governance debate because privately owned entities are to a large extent owner-managed and hence the shareholder-manager agency problem is minimal.

The external auditors of publicly quoted companies are also expected to be very reputable audit firms which have earned public reputation and also met some rigorous requirements in order to be appointed auditors of a publicly quoted company. Furthermore, by virtue of their interaction with the shareholders and managements of the public companies, these auditors are expected to be very resourceful in designing and implementation of control mechanisms, which would safeguard stakeholders' interests.

For the audit firms, the questionnaires were administered to the senior/managing partners of these firms. These personalities occupy a central position in the firm as well as in the accounting profession which gives them the suitability to knowledgeably comment on matters of the required control and enforcement procedures which are necessary to protect stakeholders' interests. For the publicly quoted companies, the questionnaires were sent to the chief executive officers of the organizations because such persons would normally be expected to adequately represent the views of the management by virtue of the position they occupy in the organization.

3.3 DATA COLLECTION

Data for this research was collected using questionnaires and discussions with the respondents. The survey part of the study was carried out through directly delivered questionnaires and in a few cases, the researcher had the opportunity of being invited by the respondents for a detailed discussion and assistance in completion of the questionnaire. A sample of the questionnaire used is attached on appendix B. The original intension of the researcher was to personally discuss the questionnaire with each respondent but attempts to book interviews was mostly turned down due to the scarcity of the respondents' time arising because of pressure of their routine work.

The use of an interview method to supplement the questionnaire responses had been selected after consideration of its advantages and disadvantages. Howard and Sharp (1987) and Sekaran (1992) identified three major advantages of interviews in research. First, in an interview, the interviewer can clarify and elaborate on issues that seem confusing. However, the interviewer should be cautious while clarifying since more often than not, non-standardized probes end up collecting the wrong data. Further more, interviews typically produce higher response rate than mailed/delivered questionnaires. This is because the presence of an interviewer usually serves to reduce the number of non-response. But more important is that the interviewer is superior in collecting extensive information, which is verified by extended discussion and probes. (Guy, Edgley, Arafat and Allen, 1987; Sekaran, 1992).

Besides the above advantages, however, interviews also exhibit certain weaknesses. Howard and Sharp (1987) argues that although most social scientists see the interview as providing quality information, it is also prone to several fallbacks. One problem is that it is extremely hard to find a way to record all the data gathered during the interview. This relates to the degree to which the interviewer wishes to structure the interview and in fact is allowed to do so. This is because the research student's control over an interview with a respondent is somewhat limited. Another pitfall about interviews is that they are time-consuming and are an expensive undertaking (Serakan, 1992).

3.4 OPERATIONALIZATION OF THE SURVEY VARIABLE

The variable for this survey is attitude. Summers (1970) defines attitude as the sum total of a man's inclinations and feelings, prejudices or bias, preconceived notions, ideas, fears, threats and convictions about any specific topic. Most authorities agree that attitudes are learned and implicit i.e. they are inferred states of the organism that are presumably acquired in much the same manner as such other internally learned activities. Attitudes are also predispositions to respond, but are distinguished from other states of readiness in that they predispose towards an evaluative process. They are those mental structures, which organize and evaluate information.

A respondent's score on the variable attitude was determined by responses to statements and preference rankings included in the questionnaire. On measurement of attitude, there is no clear-cut guidance as far as literature is concerned. Given this situation, the researcher operationalized the attitude variable through a series of statements, which were selected for their relevance to a corporate governance audit. On the preferred corporate governance auditor, the respondents were asked to list the parties they would prefer to carry out the audit in order of their preference. As the study deals with dimensions and a general evaluation of the respondents' feelings, basic analytical procedures are used in analysing the relevant research data. The research does not purport to consider the cognitive and conative dimensions, which several researchers have conceptualized. (Summers F G, 1970; Triadis H C, 1971).

The attitude scale used in determining the respondents' attitudes on the need for the audit is the Likert type of scale with five intervals ranging from strongly agree (=5) to strongly disagree (=1). An individual's attitude is obtained by summing up his score across statements. The score thus obtained represents the individual's attitude measure. The summation of the individual attitudes determines the overall view of the respondents. On the preferred corporate governance auditor, simple analytical procedures were used to obtain the number of those who ranked each suggested party and consequently determining who was the most preferred candidate.

3.5 DATA ANALYSIS

The nature of the objectives of the survey is such that the analytical procedures used to highlight the basic issues are as clear as possible. With this in mind, the survey aimed at adopting a combination of analytical procedures, which have been used in similar studies. As explained elsewhere in this chapter, the sum total attitude scores of each respondent on the first objective of the study was used.

The scores table used in determining each respondent's overall view is as follows:

	Strongly agree	Agree	Neither agree nor disagree	Disagree	Strongly disagree
Score	17 to 20	13 to 16	9 to 12	5 to 8	4

As explained under section 3.4 above, simple analytical review procedures were used to determine who was the most preferred candidate to carry out the corporate governance audit. These analysis techniques were selected after taking into consideration and simplicity of their use by various other writers. An example of such writers include Kibera (1979) who summed up respondents' attitudes on fertilizer usage. Even though the total summation is of great relevance, the survey analysis would not have been complete without a statement by statement attitude analysis which adds much weight to the total score analysis. This procedure has been used by Smith et al (1970). In their study on audit of management, they used scales on which responses to individual statements were used in the analysis. This was proved successful in highlighting differences in opinions of the respondents. A similar approach has been used by Taylor et al (1980) in their study of the attitudes and reactions to the idea of advertising by New Zealand Accountants. In their study, they found out that a statement by statement response analysis provided considerable knowledge of the total response. The presentation of the data is in the form of tables.

CHAPTER FOUR-DATA ANALYSIS AND FINDINGS

4.1 RESPONSE RATE ANALYSIS

As explained in chapter 3, questionnaires were sent to the chief executives of 42 publicly quoted companies and the senior/managing partners of 7 external audit firms, which are involved in the audit of publicly quoted companies in Kenya.

4.1.1 SUMMARY OF THE RESPONSES RECEIVED

A general analysis of the responses received can be summarized as below:

	Sample (No)	Responses (No)	No of responses as a % of the sample	% Market capitalization of the replies
Public companies	42	23	54.7	87.7
Audit firms	7	4	57.1	88.9

4.1.2 SECTORIAL ANALYSIS OF THE PUBLIC COMPANIES' RESPONSES RECEIVED

A market sector in this research is used to refer to the market sector classification used by the Nairobi Stock exchange. The following sectorial analysis of the responses received indicates that the research findings are not only representative of the overall market but also largely representing the views of each market segment as defined by the Nairobi Stock exchange.

Sector	No of companies in the sector	No of responses received	% of the number of responses received	% Market capitalization of the responses received
Agricultural sector	4	2	50.0	82.0
Commercial & services sector	9	5	55.5	84.9
Finance & investment sector	11	7	63.6	92.2
Industrial & allied	17	7	41.1	86.4
Alternative investment market segment	10	2	20.0	56.9

4.2 THE NEED FOR A CORPORATE GOVERNANCE AUDIT

4.2.1 SUMMARY OF RESULTS

The table below shows a general summary of the results of the survey on the attitudes of the respondents on whether or not there is a need for a corporate governance audit.

	Strongly agree		Agree		Neither agree nor disagree		Disagree		Strongly disagree	
	No	%	No	%	No	%	No	%	No	%
Publicly quoted companies	16	69.5	7	30.5	0	0	0	0	0	0
External auditors of publicly quoted companies	0	0	4	100	0	0	0	0	0	0

The summary results indicate a clear consensus on the need for a corporate governance audit. 69.5 % of the managements of publicly quoted companies' responses strongly felt that there was need for a corporate governance audit while the remaining 30.5 % simply agreed to the proposition. On the external auditors' responses, all the replies received agreed to the proposition of a corporate governance audit.

4.2.2 SECTORIAL ANALYSIS OF THE PUBLIC COMPANIES' RESPONSES

Sector	Strongly agree		Agree		Neither agree nor disagree		Disagree		Strongly disagree	
	No.	%	No.	%	No	%	No	%	No	%
Agricultural sector	1	50	1	50	0	0	0	0	0	0
Commercial and services sector	4	80	1	20	0	0	0	0	0	0
Finance & investment sector	4	57.1	3	42.9	0	0	0	0	0	0
Industrial & allied sector	7	100	0	0	0	0	0	0	0	0
Alternative investment segment	0	0	2	100	0	0	0	0	0	0

A sector by sector analysis still indicates an overwhelming support for a corporate governance audit particularly in the agricultural, industrial & allied, finance & investment and commercial & services sectors. At least 50 % of the respondents in all the sectors (except for the alternative investment market) strongly agreed that there should be a corporate governance audit. The two responses received from the alternative investment market also agreed to the idea of a corporate governance audit.

4.2.3 STATEMENT BY STATEMENT ANALYSIS ON THE NEED FOR A CORPORATE GOVERNANCE AUDIT

	CATEGORY OF RESPONDENTS	STRONGLY AGREE		AGREE		NEITHER AGREE NOR DISAGREE		DISAGREE		STRONGLY DISAGREE		INDEX (RATE OF AGREEMENT)	
		No	%	No	%	No		No	%	No	%	No	%
1) A report on management's adherence to corporate governance is required for decision-making purposes by third parties.	PUBLIC COMPANIES	11	47.8	9	39.2	3	13	0	0	0	0	20	86.9
	EXTERNAL AUDITORS	2	50	2	50	0	0	0	0	0	0	4	100
2) Poor management can lead to organizational failure.	PUBLIC COMPANIES	17	73.9	6	26.1	0	0	0	0	0	0	23	100
	EXTERNAL AUDITORS	4	100	0	0	0	0	0	0	0	0	4	100
3) Some information contained in annual reports that is not covered by external auditor's opinion is used by third parties for decision making.	PUBLIC COMPANIES	9	39.2	11	47.8	3	13	0	0	0	0	20	86.9
	EXTERNAL AUDITORS	2	50	2	50	0	0	0	0	0	0	4	100
4) There is some information not contained in annual reports that is useful by third parties for decision making.	PUBLIC COMPANIES	14	60.8	6	26	2	8.8	1	4.4	4.4	0	19	82.6
	EXTERNAL AUDITORS	1	25	3	75	0	0	0	0	0	0	4	100

A statement by statement analysis reveals that all the auditors' responses either agree or strongly agree with all the research questions. This is obviously a shocking confession as it leads one to want to further find out why the auditors have not then wanted to expand their business lines to offer such services if they truly believed that there was some information gap in decision making. The answers to this might range from complete ignorance by the external auditors to believing that they are not sufficiently competent to carry out such an audit.

From the publicly quoted companies' statement by statement response analysis, it is evidently clear that all the respondents largely agree with statement numbers 1, 2, 3 and 4. 13 % of the respondents are, however, neutral to statement numbers 1 and 3- i.e a report on management's adherence to corporate governance is required for decision making purposes by third parties and that there is some information contained in annual reports which is not covered by the external auditor's opinion. There is also some slight variation of the responses received from publicly quoted companies on statement number 4 i.e that some information not contained in annual reports is used by third parties for their decision making. 13.2 % of the respondents are either neutral or outrightly disagree with the statement. These exceptions may require some more investigation in a separate research work. For purposes of this study, however, we will consider the findings as inconsequential in view if the insignificant number of respondents who hold these views.

A sectorial statement by statement analysis of the public companies' responses (see appendix D) indicates a similar trend as explained above by the general statement by statement analysis.

4.3 THE MOST PREFERRED CANDIDATE TO CARRY OUT THE AUDIT

The questionnaires requested respondents to list in order of their preference who they would wish to have as their e preferred corporate governance auditor. The various names suggested include external auditors, independent management consultants and the Private Sector Corporate Governance Trust.

SUMMARY RESPONSES FROM PUBLICLY QUOTED COMPANIES

PROPOSED AUDITOR	Ranked first		Ranked second		Ranked third		Ranked fourth		Ranked fifth	
	No	%	No	%	No	%	No	%	No	%
External auditors	14	66.6	5	23.8	1	4.7	0	0	0	0
Private Sector Corporate Governance Trust	4	19	5	23.8	2	9.5	0	0	0	0
Independent management consultancy firms	1	4.7	1	4.7	3	14.3	0	0	0	0
Other regulatory authorities such as Capital Markets Authority &the Central Bank of Kenya	1	4.7	2	9.5	2	9.5	0	0	0	0
Certified Public Secretaries	0	0	1	4.7	0	0	1	4.7	0	0
Non-executive board of directors	0	0	0	0	1	4.7	0	0	0	0
Audit committees	0	0	0	0	0	0	1	4.7	0	0
Kenya Institute of Management	0	0	1	4.7	0	0	0	0	0	0
Societte General Surveillance (SGS)	0	0	0	0	0	0	0	0	1	4.7
Internal auditors	1	4.7	0	0	0	0	0	0	0	0

SUMMARY RESPONSES FROM THE EXTERNAL AUDITORS

PROPOSED AUDITOR	Ranked first		Ranked second		Ranked third		Ranked fourth		Ranked fifth	
	No	%	No	%	No	%	No	%	No	%
External auditors	4	100	0	0	0	0	0	0	0	0
Independent management consultancy firms	0	0	2	50	0	0	0	0	0	0
Other regulatory authorities such as Capital Markets Authority & the Central Bank of Kenya	0	0	1	25	0	0	0	0	0	0
Audit committees	0	0	0	0	2	50	1	0	0	0
Internal auditors	0	0	0	0	0	0	0	0	2	50

As is evident from the above tables, external auditors were ranked to be the most preferred candidate to carry out a corporate governance audit both by the publicly quoted companies and the external auditors themselves. All the external auditors ranked themselves to be the most preferred candidate to carry out such an audit. On the other hand, 66.6 % of the publicly quoted companies chose external auditors to be the most preferred candidate for such work. A further 23.8 % of the publicly quoted companies also ranked the external auditors to be the second preferred candidate.

The second most preferred corporate governance auditor was the Private Sector Corporate Governance Trust (PSCGT). Out of the public companies' responses, 19 % of these ranked PSCGT as the first preferred candidate while 23.8 % ranked it as the second most preferred. The PSCGT was, however, not mentioned by any of the external auditors' responses as a suggested corporate governance auditor. The reasons for such would need to be possibly addressed in a separate research study.

The other names, which featured prominently in the list of the preferred candidates on the external auditors' responses include audit committees, internal auditors, independent management consultancy firms and other regulatory authorities such as the Capital Market Authority and the Central Bank of Kenya. These, however, featured in the list of the publicly quoted companies' at a more insignificant level. It would be thus interesting for a more comprehensive research work to be carried out to establish the strengths and weaknesses of the suggested corporate governance auditors from the standpoint of both the external auditors and the publicly quoted companies. This would probably draw further light on the reasons each category of responses chose the above names.

A sectorial analysis of the publicly quoted companies' responses (see appendix E) on this matter revealed largely the same trend as noted above except for the alternative investment market which preferred to remain silent on their preferred choices with the argument that corporate governance had not yet been sufficiently entrenched in the Kenyan corporate sector and hence it would be inappropriate to start making suggestions on the preferred persons or organisations who could carry out a corporate governance audit. While this may be true in the case of the alternative investment market, the researcher is nonetheless reluctant to lend credence to these allegations as this would be dishonest in view of the recent corporate governance research work which clearly indicates that there is some serious corporate governance work which has been going around in the Kenyan corporate sector. Examples of such work has been widely documented by Wambua (1999) in his study of the extent to which corporate governance features and activities have been entrenched in the Kenyan environment and with a more emphasis on Commercial banking sector.

CHAPTER FIVE-CONCLUSIONS AND RECOMMENDATION

5.1 CONCLUSIONS

This study reports the results of a survey of attitudes of two groups, which have an interest in corporate governance matters in the organisation. The research questions focussed on whether or not a corporate governance audit could be necessary in the Kenyan publicly quoted companies and if so, who could best suited to carry out such an audit.

From the study, it has emerged that a corporate governance audit is required and external auditors have been largely suggested as the most preferred candidate to carry out such an audit. The Private Sector Corporate Governance Trust, internal auditors, audit committees and independent management consultancy firms have also been mentioned as some other preferred candidates though at a lower preference level.

The research findings appear thus to echo the calls by various management writers who have over the years expressed concern to the manner in which the directors' activities were not closely monitored by the shareholders and hence the increased corporate failure. Examples of such writers include Drucker (1974) Stiles (1993) and Salmon (1995). The findings also appear to agree to the American Accounting Association (1972) extended definition of an audit which defines an audit as a systematic process of objectively obtaining and evaluating evidence regarding assertions about economic actions and events to ascertain the degree of correspondence between these assertions and established criteria and communicating the results to interested users.

The suggestion that the corporate governance audit be carried out by external auditors could probably be as a results of the advantaged position gained by the external auditor when reviewing the clients' accounting systems and hence being possibly much better placed to extend their services to a corporate governance audit. As indicated in the literature review, however, there has been various suggestions that the present external auditors would require some additional training and experience before they fit into the new suggested role. Even though there are still some writers who have expressed doubts on the ability of the external auditor to competently make non-financial evaluations and judgements, it nevertheless appears from the research findings that the Kenyan corporate sector still views the external auditor to be an umpire of fairness.

The PSCGT on the other hand appears to have won the confidence of a significant proportion of the corporate sector possibly because of its publicity work on the importance of ensuring good organisational governance in Kenya. It appears from the research findings that if this Trust increased the intensity and focus of its activities further, it could as well be viewed as an equal or possibly more preferred candidate to carry out a corporate governance audit.

5.3 RECOMMENDATIONS OF THE STUDY

Having discovered that the audit function can be further extended into other service lines, the study calls for the external auditors to work towards developing more desirable service lines, which would address the society's need for a corporate governance audit. Quite certainly, however, the present day external auditor would require some additional training and technical expertise in order to be able to competently offer the extended audit services, which go beyond the traditional financial audit function. The external auditors' present familiarity with clients' accounting and control systems will no doubt be of great help in the future extension of the current audit services.

The implications of the study to the other suggested corporate governance auditors such as the Private Sector Corporate Governance Trust, internal auditors, audit committees and independent management consultancy firms is an indication that they may need to work harder to improve on their current society's perception when it comes to issues of providing the required business solutions and more particularly on matters of corporate governance.

Finally, all the relevant corporate governance stakeholders and most urgently the shareholders need to arise and put in place the necessary infrastructure for a corporate governance audit as this would provide increased value to the present day corporations and hence the various stakeholders.

5.3 LIMITATIONS OF THE STUDY

The study only involved a small number of persons who have a direct interest in corporate governance matters. The results obtained, therefore, cannot be wholly conclusive on the feelings of all the directors or Audit Partners. It nevertheless provides an insight on what might be expected if the study could have been extended to all the business chief executives in Kenya and all the external auditors.

As indicated on the research design, the study measured the respondents attitudes at one particular point in time and does not take into account the effects of any other factors which may have an effect on the respondents' attitudes at any other point in time. Given sufficient time and resources, a longitudinal survey would have been possibly better placed to overcome the limitations faced in a cross-sectional survey.

The survey instrument (the questionnaire) was also not put into any pre-testing procedure as a result of which any ambiguities and uncorrelated questions could not be ruled out. The questionnaire structuring and the issues in it were only validated using issues raised by certain authors in the literature review. Question five of the questionnaire did not, for example, attract any responses from all the respondents as it required the respondents to specify any other related corporate governance statement relating to the need for a corporate governance audit and respond as appropriate on whether they strongly agreed or otherwise. Also, the request to respondents to give any other comments they had on a corporate governance audit did not yield any tangible comments.

Being an attitude measurement test, the survey did not also try to remove any external influence variables of the respondents filling the questionnaire. As explained in the research design, for example, the complimentary interviewing process could have as well significantly influenced the feelings and attitudes of the respondents when filling up the questionnaire.

5.4 SUGGESTIONS FOR FURTHER RESEARCH

Further research work will be necessary to establish the necessary scope, frequency and control matters of such an audit.

Also a cost benefit analysis may need to be carried out to establish how useful such an audit would be.

Another area which may require further research would be to evaluate the strengths and weaknesses of the suggested corporate governance auditors with a view to empirically establishing who would be most suitable to carry out such an audit.

The study should also be broadened to include the views of more audit partners and company directors as this could tap a more expanded view on whether or not a corporate governance audit is necessary in the Kenyan corporate sector.

The views of the other interested corporate governance stakeholders such as the shareholders and creditors should be sought in order to arrive at a more all inclusive position on the matter.

APPENDIX A-REQUEST LETTER TO PARTICIPATE IN RESEARCH

TITUS M KITONGA
P.O BOX 1393
NAIROBI 00100

Date....................................

ADDRESSEE

Dear Sir/Madam

RE: REQUEST TO PARTICIPATE IN RESEARCH ON A CORPORATE GOVERNANCE AUDIT

I am a final year student at the University of Nairobi pursuing studies for the degree of Master of Business Administration (finance major). As part of the requirements of this degree, I am required to carry out research in an approved research topic such as the above and present my findings to the Faculty Board for approval.

I enclose a questionnaire for your kind attention and I will appreciate your views on the proposed corporate governance audit.

This research will be useful to the shareholders, the management and the external auditors because it will provide suggestions on how shareholder value and confidence can be increased through increased assurance that their business has been well run. The findings of the research will be strictly used for academic purposes only. Your views will also be treated with utmost confidentiality and views of individual respondents will not be mentioned without their written consent.

Once you complete the questionnaire, please return it to me using the above address (a self addressed stamped envelope is enclosed for your ease of return) or simply call me on the telephone number enclosed in this letter and I will arrange to collect the questionnaire from your office.

Thanking you in advance for your kind attention.

Yours faithfully

Titus M Kitonga

Enclosures

APPENDIX B- QUESTIONNAIRE

A SURVEY OF THE OPINIONS OF MANAGEMENT AND EXTERNAL AUDITORS OF PUBLICLY QUOTED COMPANIES ON THE NEED FOR A CORPORATE GOVERNANCE AUDIT IN KENYA

PART A

COMPANY/FIRM'S NAME..

POSTAL ADDRESS..

NAME OF OFFICER..

POSITION OF OFFICER..

PART B

SECTION I

The purpose of this section is to provide the respondent with explanations and definitions of some terminology, which may be necessary to assist the respondent in answering the questions given. These definitions include the following:

1 Corporate governance

Corporate governance can be defined as the process by which corporations are made responsible to the rights and wishes of its stakeholders. It requires the directors to act responsibly and in the best interest of the shareholders. Having executed their stewardship, the directors would need to give the shareholders a report confirming that they have profitably and efficiently run the business to the best interest of the shareholders.

For shareholders to have enhanced confidence on such a report, it may be important for an independent third party to attest to the truth and fairness of the report.

2 A corporate governance audit

This would be an investigation of a business in all its managerial aspects from the highest governing executive downwards and the making of a report as to its effectiveness or otherwise from the point of view of:

(i) profitability and efficient running of the business

(ii) compliance with generally acceptable corporate governance practices. These practices stipulate among other things that the directors plan well in advance on the organization's long-term survival and growth. They also require that appropriate managerial and control structures be put in place to ensure that the shareholders' assets are safeguarded.

APPENDIX B- QUESTIONNAIRE (Continued)

A corporate governance audit calls for the auditors to give an opinion on the management functions as he does in a financial audit.

SECTION II

1. Listed below are statements dealing with the need for an independent corporate governance audit by external auditors in Kenya. Please circle in the appropriate box to indicate your attitude on each. The are no right or wrong answers. The scaling is from 1 to 5 where 1 stands for strongly disagree while 5 stands for strongly agree.

	Strongly agree	**Agree**	**Neither agree nor disagree**	**Disa gree**	**Strongly disagree**
	5	4	3	2	1
i. A report on management's adherence to corporate governance is required for decision-making purposes by third parties.	5	4	3	2	1
ii. Poor management can lead to organizational failure.	5	4	3	2	1
iii. Some information contained in annual reports that is not covered by external auditor's opinion is used by third parties for decision making.	5	4	3	2	1
iv. There is some information not contained in annual reports that is useful by third parties for decision making.	5	4	3	2	1
v. Others. Please specify and rank	5	4	3	2	1

APPENDIX B- QUESTIONNAIRE (Continued)

1. Please suggest the person(s) or organizations, which you would consider to be most suited to carry out a corporate governance, audit. The first name would be the most suitable and the last one would be the least suitable.

   i.
   ii.
   iii.
   iv.
   v.

2. Please provide any other additional comments that you may have on the proposed corporate governance audit
   ....
   ....
   ....
....
....
....

APPENDIX C-LIST OF PUBLICLY QUOTED COMPANIES TOGETHER WITH THEIR EXTERNAL AUDITORS AS AT 31 DECEMBER 2001

COMPANY	LOCAL HEAD OFFICE	EXTERNAL AUDITORS	EXTERNAL AUDITORS' LOCAL HEAD OFFICE
1. A Bauman & Company Limited	Nairobi	KPMG Peat Marwick	Nairobi
2. African Lakes	Nairobi	PKF	Outside Nairobi
3. Athi River Mining Limited	Nairobi	Deloitte & Touche	Nairobi
4. Bamburi Cement Limited	Mombasa	Pricewaterhousecoopers	Nairobi
5. Barclays Bank of Kenya Limited	Nairobi	Pricewaterhousecoopers	Nairobi
6. BOC Kenya Limited	Nairobi	Pricewaterhousecoopers	Nairobi
7. British American Tobacco Limited	Nairobi	Pricewaterhousecoopers	Nairobi
8. Brooke Bond Kenya Limited	Nairobi	Pricewaterhousecoopers	Nairobi
9. Car & General Limited	Nairobi	Gill & Johnson	Nairobi
10. Carbacid Investment Limited	Nairobi	Deloitte & Touche	Nairobi
11. CFC Bank Limited	Nairobi	Deloitte & Touche	Nairobi
12. City Trust Limited	Nairobi	Deloitte & Touche	Nairobi
13. CMC Holdings Limited	Nairobi	Pricewaterhousecoopers	Nairobi
14. Crown-Berger Kenya Limited	Nairobi	Ernst & Young	Nairobi
15. Diamond Trust of Kenya Limited	Nairobi	Pricewaterhousecoopers	Nairobi
16. Dunlop Kenya Limited	Nairobi	Deloitte & Touche	Nairobi
17. EAAGADS Limited	Nairobi	Gill & Johnson	Nairobi
18. East African Breweries Limited	Nairobi	KPMG Peat Marwick	Nairobi

APENDIX C (Continued)

COMPANY	LOCAL HEAD OFFICE	EXTERNAL AUDITORS	EXTERNAL AUDITORS' LOCAL HEAD OFFICE
19. East African Cables Limited	Nairobi	KPMG Peat Marwick	Nairobi
20. East African Packaging Industries Limited	Nairobi	Ernst & Young	Nairobi
21. East African Portland Cement Company Limited	Nairobi	Deloitte & Touche	Nairobi
22. Express Kenya Limited	Nairobi	KPMG Peat Marwick	Nairobi
23. Firestone (East Africa) Limited	Nairobi	Pricewaterhousecoopers	Nairobi
24. George Williamson Kenya Limited	Nairobi	Deloitte & Touche	Nairobi
25. Housing Finance Company of Kenya limited	Nairobi	KPMG Peat Marwick	Nairobi
26. Hutching Biemer Limited	Nairobi	Bassan Khanna Sani	Nairobi
27. ICDC Investment CompanyLimited	Nairobi	Deloitte & Touche	Nairobi
28. Jubilee Insurance Company Limited	Nairobi	Pricewaterhousecoopers	Nairobi
29. Kakuzi Limited	Nairobi	Pricewaterhousecoopers	Nairobi
30. Kapchorua Tea Company Limited	Nairobi	Deloitte & Touche	Nairobi
31. Kenya Airways limited	Nairobi	Ernst & Young	Nairobi
32. Kenya Commercial Bank Limited	Nairobi	Ernst & Young	Nairobi
33. Kenya Hotel Properties Limited	Nairobi	Pricewaterhousecoopers	Nairobi
34. Kenya National Mills Limited	Nairobi	Gill & Johnson	Nairobi
35. Kenya Oil Company Limited	Nairobi	Pricewaterhousecoopers	Nairobi

APENDIX C (Continued)

COMPANY	LOCAL HEAD OFFICE	EXTERNAL AUDITORS	EXTERNAL AUDITORS' LOCAL HEAD OFFICE
36. Kenya Orchands Limited	Nairobi	Kassim Bharadia & Company	Narobi
37. Kenya Power & Lighting Company Limited	Nairobi	Deloitte & Touche	Nairobi
38. Limuru Tea Company Limited	Outside Nairobi	Pricewaterhousecoopers	Nairobi
39. Marshalls (East Africa) Limited	Nairobi	Pricewaterhousecoopers	Nairobi
40. Mumias Sugar Limited	Mumias	Deloitte & Touche	Nairobi
41. Nation Media Group Limited	Nairobi	Pricewaterhousecoopers	Nairobi
42. National Bank of Kenya Limited	Nairobi	Deloitte & Touche	Nairobi
43. National Industrial Credit Bank Limited	Nairobi	Deloitte & Touche	Nairobi
44. Pan African Insurance Company Limited	Nairobi	Pricewaterhousecoopers	Nairobi
45. Rea Vipingo Plantations Limited	Nairobi	Pricewaterhousecoopers	Nairobi
46. Sasini Tea & Coffee Limited	Outside Nairobi	Ernst & Young	Nairobi
47. Standard Chartered Bank Limited	Nairobi	KPMG Peat Marwick	Nairobi
48. Standard Newspapers group	Nairobi	KPMG Peat Marwick	Nairobi
49. Total Kenya Limited	Nairobi	Deloitte & Touche	Nairobi
50. Tourism Promotion Services Limited	Nairobi	Pricewaterhousecoopers	Nairobi
51. Uchumi Supermarkets Limited	Nairobi	Pricewaterhousecoopers	Nairobi
52. Unga Group Limited	Nairobi	Gill & Johnson	Nairobi

APPENDIX D

SECTORIAL STATEMENT BY STATEMENT ANALYSIS OF THE PUBLIC COMPANIES' RESPONSES ON THE NEED FOR A CORPORATE GOVERNANCE AUDIT

	SECTOR	STRONGLY AGREE		AGREE		NEITHER AGREE NOR DISAGREE		DISAGREE		STRONGLY DISAGREE	
		No	%	No	%	No	%	No	%	No	%
1) A report on management's adherence to corporate governance is required for decision-making purposes by third parties.	Agricultural sector	1	50	1	50	0	0	0	0	0	0
	Commercial sector and services sector	3	60	2	40	0	0	0	0	0	0
	Industrial & allied	5	71.4	2	28.6	0	0	0	0	0	0
	Finance and investment sector	2	28.6	4	57.1	1	14.3	0	0	0	0
	Alternative investment market	2	100	0	0	0	0	0	0	0	0
2) Poor management can lead to organizational failure	Agricultural sector	2	100	0	0	0	0	0	0	0	0
	Commercial and services sector	3	60	2	40	0	0	0	0	0	0
	Finance & investment sector	5	71.4	2	28.6	0	0	0	0	0	0
	Industrial & allied	5	71.4	2	28.6	0	0	0	0	0	0
	Alternative investment market	2	100	0	0	0	0	0	0	0	0
3) Some information contained in annual reports that is not covered by external auditor's opinion is used by third parties for decision making.	Agricultural sector	1	50	0	0	1	50	0	0	0	0
	Commercial & services sector	3	60	2	40	0	0	0	0	0	0
	Finance & investment sector	1	14.3	5	71.4	1	14.3	0	0	0	0
	Industrial & allied	5	71.4	2	28.6	0	0	0	0	0	0
	Alternative investment sector	2	100	0	0	0	0	0	0	0	0
4) There is some information not contained in annual reports that is useful by third parties for decision making.	Agricultural sector	1	50	0	0	0	0	1	50	0	0
	Commercial and services sector	2	40	2	40	1	20	0	0	0	0
	Finance & investment sector	4	57.1	2	28.6	1	14.3	0	0	0	0
	Industrial & allied	7	100	0	0	0	0	0	0	0	0
	Alternative investment market	2	100	0	0	0	0	0	0	0	0

APPENDIX E

SECTORIAL ANALYSIS OF THE PUBLIC COMPANIES' RESPONSES ON WHO SHOULD CARRY OUT THE CORPORATE GOVERNANCE AUDIT

PROPOSED AUDITOR	SECTOR	RANKED FIRST		RANKED SECOND		RANKED THIRD		RANKED FOURTH		RANKEI FIFTH	
		No	%	No	%	No	%	No	0	No	%
1) External auditors	Agricultural sector	2	100	0	0	0	0	0		0	0
	Commercial & services sector	2	40	1	20	1	20	0	0	0	0
	Finance & investment sector	6	85.7	1	14.2	0	0	0	0	0	0
	Industrial & allied	4	57.1	3	42.8	0	0	0	0	0	0
	Alternative investment sector	0	0	0	0	0	0	0	0	0	0
2) Private Sector Corporate Governance Trust	Agricultural sector	0	0	0	0	0	0	0	0	0	0
	Commercial & services sector	1	20	0	0	1	20	0	0	0	0
	Finance & investment sector	1	14.2	2	42.8	0	0	0	0	0	0
	Industrial & allied	2	28.5	2	28.5	0	0	0	0	0	0
	Alternative investment sector	0	0	0	0	0	0	0	0	0	0

APPENDIX E (Continued)

PROPOSED AUDITOR	SECTOR	RANKED FIRST		RANKED SECOND		RANKED THIRD		RANKED FOURTH		RANKED FIFTH	
		No	%	No	%	No	%	No	%	No	%
3) Independent management consultancy firms	Agricultural sector	0	0	0	0	1	50	0	0	0	0
	Commercial & services	1	20	1	20	0	0	0	0	0	0
	Finance & investment	0	0	0	0	1	14.2	0	0	0	0
	Industrial & allied	0	0	0	0	2	28.5	0	0	0	0
	Alternative investment	0	0	0	0	0	0	0	0	0	0
4) Other regulatory authorities such as Capital Markets Authority & the Central Bank of Kenya	Agricultural sector	0	0	0	0	0	0	0	0	0	0
	Commercial & services	0	0	1	20	0	0	0	0	0	0
	Finance & investment	0	0	0	0	1	14.2	0	0	0	0
	Industrial & allied	1	14.2	1	14.2	0	0	0	0	0	0
	Alternative investment	0	0	0	0	0	0	0	0	0	0
5) Certified Public Secretaries	Agricultural sector	0	0	1	50	0	0	0	0	0	0
	Commercial & services	0	0	0	0	0	0	0	0	0	0
	Finance & investment	0	0	0	0	0	0	0	0	0	0
	Industrial & allied	0	0	0	0	0	0	1	14.2	0	0
	Alternative investment	0	0	0	0	0	0	0	0	0	0

APPENDIX E (Continued)

PROPOSED AUDITOR	SECTOR	RANKED FIRST		RANKED SECOND		RANKED THIRD		RANKED FOURTH		RANKED FIFTH	
		No	%	No	%	No	%	No	%	No	%
6) Non-executive board of directors	Agricultural sector	0	0	0	0	0	0	0	0	0	0
	Commercial & services	0	0	0	0	1	20	0	0	0	0
	Finance & investment	0	0	0	0	0	0	0	0	0	0
	Industrial & allied	0	0	0	0	0	0	0	0	0	0
	Alternative investment	0	0	0	0	0	0	0	0	0	0
7) Audit committees	Agricultural sector	0	0	0	0	0	0	0	0	0	0
	Commercial & services	0	0	0	0	0	0	1	20	0	0
	Finance & investment	0	0	0	0	0	0	0	0	0	0
	Industrial & allied	0	0	0	0	0	0	0	0	0	0
	Alternative investment	0	0	0	0	0	0	0	0	0	0
8) Kenya Institute of Management	Agricultural sector	0	0	0	0	0	0	0	0	0	0
	Commercial & services	0	0	0	0	0	0	0	0	0	0
	Finance & investment	0	0	1	14.2	0	0	0	0	0	0
	Industrial & allied	0	0	0	0	0	0	0	0	0	0
	Alternative investment	0	0	0	0	0	0	0	0	0	0

APPENDIX E (Continued)

PROPOSED AUDITOR	SECTOR	RANKED FIRST		RANKED SECOND		RANKED THIRD		RANKED FOURTH		RANKED FIFTH	
		No	%	No	%	No	%	No	%	No	%
9) Societte General Surveillance (SGS)	Agricultural sector	0	0	0	0	0	0	0	0	0	0
	Commercial & services	0	0	0	0	0	0	0	0	0	0
	Finance & investment	0	0	0	0	0	0	0	0	0	0
	Industrial & allied sector	0	0	0	0	0	0	0	0	1	14.2
	Alternative investment	0	0	0	0	0	0	0	0	0	0
10) Internal auditors	Agricultural sector	0	0	0	0	0	0	0	0	0	0
	Commercial & services	1	20	0	0	0	0	0	0	0	0
	Finance & investment	0	0	0	0	0	0	0	0	0	0
	Industrial & allied sector	0	0	0	0	0	0	0	0	0	0
	Alternative investment	0	0	0	0	0	0	0	0	0	0

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