

**ROLE OF AUDIT COMMITTEES IN PROMOTING CORPORATE
GOVERNANCE AND ACCOUNTABILITY IN CONSTITUENCY
DEVELOPMENT FUND MANAGEMENT IN NAIROBI PROVINCE**

BY


MOKAYA N. O.

**A RESEARCH PROJECT SUBMITTED TO THE DEPARTMENT OF FINANCE
AND ACCOUNTING, FACULTY OF COMMERCE UNIVERSITY OF NAIROBI
IN PARTIAL FULFILLMENT OF REQUIREMENTS FOR THE DEGREE OF
MASTER OF BUSINESS ADMINISTRATION (MBA).**

OCTOBER, 2010

DECLARATION

This project is my original work and has not been presented for a degree in any other University.

Sign: 

Date: 15/11/2010

Mokaya N. Oriku

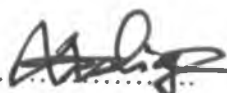
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This project has been submitted for examination with my approval as the university supervisor.

Mr. Herick O. Ondigo

Lecturer S.O.B

University of Nairobi

Sign: 

Date: 15/11/2010

DEDICATION

To my dear wife Everline, son Victor, daughter Vena, and my dear mother Peninah
Moraa

ACKNOWLEDGEMENT

This study in its present form has been made possible by a number of people and institutions to whom I am indebted and I would highly like to acknowledge their contributions. To my supervisor, Mr. Herick O. Ondigo, project moderator, Mrs. Angeline Kithinji, Dr. Josiah Aduda, Mr. Okello, Dr. Ogutu, Mirrie, Anyangu, Karanja, Gichana and Lishenga. University of Nairobi Library staff, MBA lecturers, lower kabete staff and my fellow MBA student 2008 to 2010. I extend my most sincere thanks for their guidance, suggestions comments and constant encouragement throughout the period of this research project.

I am grateful to the Nairobi province eight CDF and those who responded to my questionnaire and thus made it possible for me to compile this project.

I thank Gladys Maina and Carrolyne Omondi for typing and setting my project work, I thank my employer, Teachers Service Commission and University of Nairobi for granting me the opportunity to pursue the MBA course.

Last and all important the ALMIGHTY GOD for free life and friendship in this wonderful world.

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ABSTRACT

The purpose of this study is to present a case for the need for audit committee in Constituency Development Fund to promote corporate governance and accountability in constituency development fund management in Nairobi Province.

The paper provides an analysis and a survey of 8 constituencies of Nairobi province in the field of cooperative governance and accountability in constituencies development fund management of the extent of engagement research in the field of corporate governance and accountability in constituency Development Fund management and present case for further research that may be directed to constituencies outside Nairobi province.

The study found out that the audit committee should be established in constituency development fund in Nairobi province to improve corporate governance accountability and management. It recommends audit committee to enhance CDF performance and improve relationships among the major players in CDF governance. The lack of “engaging audit committees” is found to be due to concerns about increasing the breadth of participants in the constituencies’ development fund governance and accountability and “managerial capture”.

This paper recommends that the audit committee can play a great role in promoting corporate governance and accountability in CDF, improve the relationships among the major players in CDF corporate governance.

LIST OF ABBREVIATION

AAP	Annual Audit Plan
AC	Audit committee
CDC	Constituency Development Committee
CDF	Constituencies Development Fund
CEO	Chief Executive Office
CEO	Chief Executive Officer
CFO	Chief Finance Officer
CMA	Capital Markets Authority
IAS	International Accounting Standards
IIA	Institute of Internal Auditors
IMF	International Monetary Fund
KCC	Kenya Cooperative Creameries
KNAC	Kenya National Assurance Company
LATF	Local Authority Transfer Fund
MOU	Memorandum of Understanding
MP	Member of Parliament
MSC	Mumias Sugar Company
NARC	National Alliance Rainbow Coalition
NSE	Nairobi Stock Exchange
NTA	National Tax Payers Association
SCAC	State Corporations Advisory Committee
SPSS	Statistical Package for Social Sciences
UK	United Kingdom
USA	United States of America
WB	World Bank

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Corporate governance has become a topical issue in the modern world following many corporate failures. The fall of Kenya Co-operative Creameries (KCC), Kenya National Assurance Company (KNAC) in the 1990s and early 2000 and the fall of giant corporations such as WorldCom and Enron in USA, and Parmalat in Italy have brought to the centre stage the issue of corporate governance and intensified the need for improved governance of business enterprises.

The private sector corporate Governance Trust (1999) defines corporate governance as the manner in which the power of a corporate is exercised in the stewardship of the corporations total portfolio of assets and resources with the objective of maintaining and increasing shareholders value and satisfaction of other stakeholders in the context of its corporate mission. Corporate governance is about promoting fair, efficient and transparent administration of corporations to meet well defined objectives. It is also about promoting systems and structures of operating and controlling corporations with a view to achieving long-term strategic goals that satisfy the owners, suppliers, customers and financiers while complying with legal and regulatory factor and audit committee in corporations are key to effective corporate governance. Bramwel (2009). The guidelines require that the internal audit function should be performed with impartiality. Proficiency and due care. The audit committee should determine the areas of control or influence of the internal audit function and in particular.

Review any appraisal or assessment of the performance of members of the internal audit function; Approve any appointment or termination of senior staff member of the internal audit function; Ensure that the internal audit function is independent of the activities of the company and is performed with impartiality, proficiency and due professional care; Determine effectiveness of the internal audit function, and be informed of resignations of internal audit staff members and provide the resigning staff an opportunity to submit reason (s) for resigning. The constituencies Development Fund Act and Promulgated Constitution 2010.

1.1.1 Constituency Development Fund (CDF) in Kenya

The Kenyan CDF history can be traced to the 2002 general election where the National government created a new fund where the 210 constituencies will be allocated 5 percent of the National revenue as devolved funds. The CDF was a system proposed by the NARC government on resource distribution to constituencies but has created powerful political bureaucracies in CDF projects administration and accountability. The CDF idea has its origin in Rwanda before borrowed by Uganda and then Kenya. In the proposed draft constitutions Kenya is to be divided into 47 counties based on districts created in 1992. In the draft the national government will be allocated 15 percent of national revenue in addition to the CDF politically then, there could be concern over the power that the governors and senators will have over MPs and over control of devolved funds. There will be 294 proposed constituencies with smaller units than the 47 counties. That means that one county could have more than four constituencies and therefore, that one governor will have larger constituency to control and govern than a member of parliament (MP). The county governments will consist of a county assembly and a county executive committee. The executive committee will implement the county and national laws.

1.1.2 Functions of Constituency Development Funds

Currently the CDF Act 2003 allow for establishment of a board to be known as the constituencies Development Fund Board (CDFB) as a body corporate with perpetual succession and a common seal and shall in its corporate name perform the following functions: sued and sue; take purchasing or otherwise acquiring, holding, charging or disposing of movables and immovable property; borrow money or making investments; and doing or performing all other acts or things for the proper performance of its functions (CDF Act 2003).

1.1.3 Constituency Development Fund (CDF) National Board of Management (32 members)

The CDF board currently is currently administered by a board of management consisting of:- the permanent secretary of the ministry of economic planning; the permanent

secretary ministry of finance; the clerk of the National assembly; the attorney general; eight persons, qualified in matters relating to finance, accounting, engineering, economics, community development, or law, appointed by the minister; four persons, qualified in matters of relating to finance, accounting, engineering, economist, community development or law; the chief executive officer as ex-officio member and secretary to the board; the minister then shall appoint the chairperson of the board from amongst the eight persons appointed; four nominees, two of who shall be men.

The total of 32 (thirty two) names taking into account regional balance of the people of Kenya; appoint nine (9) persons, at least one from each of the eight organizations and at least a third of the appointees to be from either gender, to be members of the board. The name of the person proposed to be appointed as the chief executive officer to be submitted to parliament for approval before the appointments are made. (CDF Act, 2003).

1.1.4 Composition of the Constituency Development Committee (CDC) 15 members

The CDF Act 2003 provides for the establishment of CDF for every constituency, which shall be constituted and convened by the elected member of parliament, to have a maximum of fifteen (15) members, comprising of elected members of parliament; two councilors in the constituency; one district officer in the constituency; two persons representing religious organization in the constituency; two men representatives from the constituency; two women representatives from the constituency; one person representing the youth from the constituency; one person nominate from among the active NGOs in the area if any; a maximum of three other persons from the constituency such that the total number does not exceed fifteen (15); and an officer of the board seconded to the constituency development fund committee by the board who shall be ex-officio.

1.2 Statement of the Problem

There has been public outcry on mismanagement and embezzlement of CDF funds by various constituency Development Funds (CDF) board.

According to the report by the lobby group, National Taxpayer Association NTA (2010) taxpayers have lost about shs 445 million in the financial year 2006/2007 and 2007/2008.

The stakeholders mainly continue to view CDF as alternative institutions and main

channels with the ability to provide public services while at the same time exercising some control over governance. However, there are some important areas for improvement among CDF institutions. First and foremost is internal governance, this includes decision making processes, division of roles between the CDF board and audit committee (executives) as well as issued related to the establishments of a clear vision, mission and objectives of the CDF board and CDF audit committee.

A number of surveys and empirical tests have been carried out on the functioning and role of audit committees in various courtiers. In Canada Maingant and Zeghal (2000), they were quoted by Josh (2004), investigated the motives, composition, selection, and frequency of audit committee meetings, audit committees relationships with internal and external auditors and its broader role. In the USA, a study by Abbot et al (2002) addressed the impact of certain audit committees characteristics identified by the blue ribbon committee on the improving the effectiveness of corporate audit committees on the likelihood of financial misstatement (Braitta 1999).

In Kenya, several studies have been carried out in the area of corporate governance, Jebet (2001) examined governance practices of quoted companies, Mwangi (20002) examined the governance practices in the insurance industries while Mucuri (2002) examined the governance in motor vehicle industries, Gakuo (2003) and Wangombe (2003) examined governance practices among the NGO's in Nairobi and in cooperative societies respectively. Mwangi (2004) looked at factors influencing board composition. A study by Hussein (2003) examined the audit chapter, composition frequency of meetings and effectiveness of audit committees. The study, however, only examined whether the audit committees complied with CMA guidelines. Goddard (2000) stated that audit committees have become more important and prevalent in recent year but their is a relative paucity of empirical research concerning their values. Kalbers and Fogarty (1993) in research cited by Pomeranz (1997) indicated that the value of whether audit committees are actively discharging their important responsibility remains insufficiently under stood.

More recently Riro (2005) conducted a survey of the audit committees and corporate governance in Kenya with the objective of determining the role audit committee can play in good corporate governance. Mutiga (2006) conducted a case study on the perceived role in general auditor in corporate governance in general public institutions. In this study

he focused on the role of an auditor and sought to determine the role of external auditor in injecting good corporate governance in Kenyan organizations. There was need, therefore, for a study to be carried out to examine the role of an audit committee in promoting corporate governance and accountability management of constituency development funds in Nairobi province in Kenya. Therefore the need of this study to find out the roles of audit committee in promoting corporate governance and accountability of constituency development fund management in Nairobi Province?

1.3 Objective of the Study

The main objective of the study was to establish the role of the audit committee in promoting corporate governance and accountability of constituency development fund management in Nairobi province.

1.4 Significance of the Study

This study is beneficial to a number of stakeholders including:

Government

CDF audit committees is likely to lead to reduction of administrative burdens on CDF programmes and projects implementation and accountability among constituencies of the country. The CDF audit committees would inform the government on achievement made so far on CDF funds.

Potential Investors

Local investors and internal investors interested in purchasing/funding CDF owned projects will use the findings of this study and turn around these cash drained CDF projects into profit making programmes/ projects through effective management.

Policy Makers

Policy makers require information to enable them put in place sound policies that would enhance financial discipline and mobilize managerial and financial autonomy aimed at having CDF programmes and projects operate on commercial principles. This study would provide such relevant information for policy formulation in CDF sector.

Academia

The study would add to the wide academia gap of knowledge in this area of CDF governance and accountability which will in turn be used to trigger subsequent studies in the sub areas Local Authority Transfer Fund (LATF) of the same topic.

Regulators

The findings would give regulators information that would facilitate their ability to put in place appropriate regulations for CDF programmes and projects in order to enable them operate like programmes and projects in the private sector.

The International Monetary Fund (IMF) and World Bank (WB)

The IMF has been pushing governments in developing countries to give up commercial goods productions and services provision including CDF programmes and leave them in the hands of the stakeholders/citizens. The findings of this study will give them an opportunity to review the effectiveness of this conditioning especially in the CDF sector.

Capital Market Authority

Information that would facilitate their desire and role of audit committees in good corporate governance in public sector.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter gives a range of documented literature related to the study's proposed problem and to provide a basis of developing understanding and establish appropriate scope in order to align objectives to existing knowledge. The areas considered important for the review include a general description of corporate governance theory, accountability theories, mechanisms of ensuring accountability in the CDF corporate failures, analysis of audit committee processes the empirical review.

2.2 Theoretical Review

2.2.1 Corporate governance theories

Corporate governance explains how to promote fair, efficient and transparent administration of corporations to meet well defined objectives. It is also about promoting systems and structures of operating and controlling corporations with a view of achieving long term strategic goals that satisfy the owner's suppliers, customers and financiers while complying with legal and statutory requirements. Further it involves meeting environmental and society needs and an efficient process of value-creating and value adding. (CMA guidelines on corporate governance issue 2002). Establishment of an audit committee and internal audit function represent an important step towards promoting good corporate governance. A board that works together with its internal audit will have access to fresh and independent perspective on some of the issues that really matter to the business.

The guidelines of corporate governance developed by the CMA require that the board of directors regularly review the company processes and procedures. This will ensure the effectiveness of the company's internal systems of control and that the accuracy of its reporting and financial results are maintained at a high level all times. The internal audit department perfectly performs this role for the board of directors as it discharges its responsibilities by reviewing and evaluating the effectiveness of internal control systems

and providing assurance to the management that the systems of internal control are adequate, effective and reliable (effective corporate governance framework CMA 2002). The guidelines by CMA recommended that all state-owned enterprises establish audit committees and internal audit functions as part of enhancing good corporate governance as detailed by the CMA guidelines. The state corporations advisory committee, which among other duties is mandated to review and investigate the affairs of state corporations and advice on the appointment, removal or transfer of officers and staff of state corporations should the CMA guidelines and make them mandatory requirements for public enterprises. Failure to do this, the public sector's contribution to the economic development will continue falling short of expectations, output growth will be sluggish, quality and productivity levels will be low, and the sector will continue imposing heavy financial and managerial burdens on government and the general Kenyan public.

2.2.1.1 Main players in Corporate Governance

The main players in corporate governance include the Board of Directors, board committees, company secretaries, external and internal auditors, management team, shareholders and other stakeholders. The Board of Directors has a duty of setting up the company's strategic aims, providing the necessary leadership and supervising the management of the business. It also reports to the shareholders on their stewardship and appoints the Chief Executive Officer (CEO) and senior managers particularly the head of finance and the company secretary. The composition of the board should be balanced in terms of executive and non-executive directors of diverse skills or expertise in order to ensure that no individual can dominate the Board's decision making process. There should be formal and transparent procedures of appointing directors to the board. All directors should disclose any potential area of conflict that may undermine their individual position or service as a director. Executive directors should have a fixed service contract with a provision for renewal subject to performance appraisal.

2.2.1.2 Corporate Governance and Audit Committee Effectiveness

Following high profile corporate governance failures there have been proposals and actions in a number of countries concerning the responsibilities and powers of audit committees, their mandatory or voluntary status, membership and independence. This

trend of development can be seen as part of a wider agenda regarding the potential 'globalization' of corporate governance. Following similar projects in areas of financial reporting, harmonization of governance structures internationally is an important area of current development. Indications of these are apparent from evidence of a significant rise and harmonization in the use of audit committees internationally (Collier and Zaman, 2005), and from the European Commission's 8th Directive requiring all public interest entities in the European union to have an audit committees.

The effectiveness of audit committees has been a subject of some concern to both researchers and regulators (see for example Spira, 2002 and Turley and Zaman, 2003 and 2004). A typical example of this concern is the following reaction to the USA case of Enron, where the audit committees has been criticized for failing to identify or prevent certain practices within the company.

2.2.1.3 Historical Development of Audit Committees

The Sarbanes-Oxley Act of 2002 defined an audit committee as a committee (or equivalent body) established by and amongst the board of directors of an issuer for the purpose of overseeing the accounting and financial reporting processes of the issuer and audits of the financial statements of the issuer. Pomeranz (1997) stated that the audit committee represents a standing committee of the board of directors that is charged with dealing with audit related concerns. The Accountants international Study Group (1977) cited by Goddard (2000) defined an audit committee as a committee of directors of a corporation whose specific responsibility is to review the annual financial statements before submission to the board of directors. The committee generally acts as a liaison between the auditor and the board of directors.

Audit committees were first publicly endorsed in 1940 in the aftermath of the McKesson & Robbins (1939) scandal in the USA, when both the Securities and Exchange Commission (SEC) and the New York Stock Exchange (NYSE) advocated their creation (Attwood 1986). The NYSE issued recommendations, which stated, "Where applicable, the selection of the auditor by a special committee of the board appears desirable" (Braiotta 1999). Although the term audit committee was not mentioned as such, several companies, for example, General Motors, established audit committees as a result of the McKesson and Robbins scandal. This scandal alerted the corporate community and the

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accounting profession that appointment of an audit committee by the board of directors should be recognized as an important action.

Until 1967 the concept of the audit committee received little support, and the functions of these committees remained undefined (Braiotta 1999). In July 1967 the executive committee of the American Institute of Certified Public Accountants (AICPA) recommended that publicly held corporations establish audit committees of members outside the board of directors. External

auditors started communicating with the audit committees whenever any significant question having material bearing on the company's financial statements had not been satisfactorily resolved at the management level (Braiotta 1999).

Braiotta (1999) goes on to state that during the 1970's the role and responsibilities of audit committees in the U.S received a great deal of attention because of the post-Watergate discoveries of illegal political contributions and overseas bribes. Thus the investing public demanded greater corporate accountability to increase the confidence in the quality of financial reporting. In view of the separation of ownership and management, shareholders and other constituencies needed more assurance with respect to both internal and external auditing processes and the financial reporting process.

In response to those demands, SEC in 1972 issued Accounting Series Release number 123 Standing audit committees composed of outside directors', which stated in part: the SEC endorses the establishment by all publicly held companies of audit committees composed of outside directors. SEC urged the business and financial communities and all shareholders of such publicly held companies to lend their full and continuing support to the effective implementations of the recommendations in order to assist in affording the greatest possible protection to investors who rely upon such financial statements (Braiotta 1999).

In 1974 the SEC issued Accounting Series Release (ASR) number 165 which stated that disclosure is required of the existence and composition of the audit committee of the board of directors. The release also stated that the commission had already expressed its judgment that audit committees made up of outside directors have significant benefits for the company and its shareholders. The disclosure would make the shareholders aware of the existence and composition of the audit committee and if no audit or similar committee

exists, the disclosure of that fact was expected to highlight its absence (Braiotta 1999) While the SEC issued the directive in ASR No 165, the NYSE made the first official mandatory recognition of the need for an audit committee when it issued an audit committee policy statement.

The policy statement stated that each domestic company with common stock listed on the exchange, as a condition of listing and continued listing of its securities on the exchange shall establish no later than June 30, 1978, and maintain thereafter an audit committee, composed solely of directors independent of management and free of any relationship that, in the opinion of the board of directors, would interfere with the exercise of independent judgment as a committee member, Directors who are affiliates of the company or its subsidiaries would not be qualified for audit committee membership (Braiotta 1999). In addition to the aforementioned events, there were a series of court actions with respect to the establishment of audit committees. For example in Penn Central case cited in Braiotta (1999), the SEC emphasized the critical importance of the directors' responsibility as well as 'greater utilization of public and independent directors'. In the Mattel case, the SEC sought a consent injunction against the registrant for false financial reporting. As a result a court order was issued requiring Mattel to establish and maintain an audit committee.

Similarly, a US District court ordered Lum's Inc to establish a standing audit committee because the registrant was charged with proxy fraud in connection with future acquisition of business. Finally, in the Killearn Properties case, the court ordered the establishment of an audit committee because the registrant failed to provide a prospectus in accordance with the securities laws. In this particular case, the court outlined the specific functions for the committee, which included, a review of independent audit engagement, internal accounting controls, the internal audit function, the code of conduct, all public releases of financial information and the activities of the officers and directors. There is no doubt that the court actions provided a framework for the functions of audit committees and the question of what constitutes proper standards and practices for these committees was emerging through court settlement (Braiotta 1999).

The establishment of an audit committee is, however, not a panacea for all corporate governance problems. As Pomeranz (1997) stated, it is a well-known fact that the mere

labeling of a group of directors “audit committee” will not by itself create an effective monitoring committee. In this demanding environment, it is important for audit committees to focus on the process that supports effective oversight. This goes beyond mere compliance with the rules, requires careful consideration of an audit committee framework that facilitates the coordination of the activities and information needed to support the committee’s understanding, and monitoring of the company’s financial reporting process (KPMG 1999). Over the past few years, investors, regulators, corporate boards, and executives have debated on how corporations should be governed. Out of the controversy, a number of reports of corporate governance principles were issued with particular emphasis on the proper role of the audit committees.

The Treadway Report (Treadway Commission 1987) was the first such report issued in October 1987. It identified corporate governance principles that would significantly reduce the potential for fraudulent financial reporting. This report was the first formal document on audit committee responsibilities, and set standards of best practice rather than common practice. The major recommendations were that audit committees should have charters specifying members’ responsibilities and only independent directors should serve on the committees. The Cadbury Committee of 1992 in the UK also made similar recommendations,

“The Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees” (1999) formed by SEC, urged all companies regardless of their size to make a good faith attempt to follow its recommendations in improving the audit committees’ functions. The Blue Ribbon Committee (BRC) report included ten recommendations and five guiding principles for improving the performance of audit committees that should ultimately result in better corporate governance.

2.2.1.4 Functions of Audit Committees

Audit committees should have responsibilities tailor made for their organization. However, the primary function of the audit committees is to assist the board in fulfilling its oversight responsibilities by reviewing the financial information that will be provided to the shareholders and others, the systems of internal controls, which management and the board of directors have and all audit processes (Bean 1999). Bean (1999) outlined the

general responsibilities the audit committee provides open avenues of communication among internal auditors, the independent auditor and the board of directors, The audit committee must report actions to the full board of directors and make appropriate recommendations.

ii. The audit committee has the power to conduct or authorize investigations into matters within the committee's scope of responsibilities. The committee is authorized to retain independent counsel, accountants or others if needed to assist in an investigation.

Several studies have been undertaken on the audit committees' oversight responsibilities. In general, the findings indicated a lot of variations in both perceived and stated responsibilities. Cooper and Lybrand (1995), DeZoort (1997) found that audit committee responsibilities revolved mainly in the areas of financial reporting, auditing and overall corporate governance. Kalbiers and Fogarty (1993) found that the responsibilities of audit committee included oversight of financial reporting, external auditor and internal controls.

2.2.1.5 Committee Charter

Pomeranz (1997) defined a charter as a formal statement of the charge, designed to acknowledge the existence of the audit committee in the corporate by laws. Guy (2001) argued that every company that has an audit committee should develop a tailor made charter for the committee. The board should approve the charter, and it serves as a guide to the audit committee in carrying out the responsibilities delegated to it by the full board. As a prerequisite for the effective performance of the audit committee, Bralotta (1999) stated that the board of directors should either pass a formal resolution or amend the by-laws of the corporation in order to document the establishment of the committee. Bean (1999) argued that a comprehensive charter enhances the effectiveness of the audit committee, serving as a roadmap for committee members, a well thought out charter should be tailor made for the company, describe the committee's composition, and specify access to appropriate resources. Bean (1999) also argued that a good audit committee charter organizes committee members' responsibilities providing a systematic structure for discussions between the committee and management, the public accountant and others. Using the charter as a checklist focuses an audit committee's efforts and makes it much more effective than it otherwise might have been. KPMG (1999) stated

that the audit committee charter has become an increasingly important document for helping members to focus on their specific responsibilities and also to help shareholders to evaluate the role and responsibilities of the audit committees.

The audit committee is responsible to the rest of the board and the shareholders, and its charter details what the shareholders reasonably can expect the committee members to do. Nonetheless, even though a good charter exists and the audit committee faithfully discharges the duties described by it, changing conditions can make a periodic review and update advisable. Thus, Bean (1999) stated that the best audit committee charters are living, changing documents.

2.2.1.6 Independence and Financial Literacy of Audit Committee Members

One of the most important variables in the composition of an audit committee is the question of independence (Joshi 2004). Braiotta (1999) stated that the effectiveness of the audit committee depends on the background of the members and of the chairman. He argued that the membership of the audit committee should consist of both financial and non-financial people so that the committee can draw upon members from various professionals such as accounting, economics, education, psychology, and sociology. Equally important, Braiotta (1999) stated that the chairman has a critical role in coordinating the committee's tasks. The success or failure of the operation could depend on the chairman and therefore such a person should be chosen with great care. Although there is general consensus regarding the size of audit committees, obviously, the number of members will vary from corporation to corporation. The number of members depends not only on the committee's responsibilities and authority, but also on the size of the board of directors and the company (Braiotta 1999)

Bean (1999) argued that only independent directors should serve on the audit committees, The Blue Ribbon Committee also recommends that only independent directors should serve on the audit committees, a recommendation that was adopted in Kenya by the Capital Markets Authority (CMA 2002). However, Attwood (1986) argued that the composition of the audit committee would depend on the circumstances of the particular company. Bean (1999) described an independent director as one who is free of any relationship that could influence his or her judgment as a committee member. An independent director may not be associated with a major vendor to, or a customer of, the

company. When there is doubt about independence, Bean (1999) advised that the director should excuse himself from any discussions that might be influenced by that relationship. Pomeranz (1997) stated that there is a concern as to what constituted independence on the part of an audit committee member. He argued that a further decision needs to be made as to whether emphasis should be placed on independence in fact rather than on independence on appearance.

Herdman (2002) argued that because the road to becoming an audit committee member begins with the nomination process, independent parties, not the CEO/chairman, should be responsible for nominating members of the audit committee. Herdman (2002), quoting former SEC chairman Rodhills, argued that an ineffective audit committee should be considered a material weakness in internal controls, and that a prerequisite to effectiveness is the total independence of the members of the committee, including the nomination process.

Tackett (2004) stated that although the audit committee represents the interests of stockholders, current procedures make it difficult for an individual stockholder to become a candidate for the board of directors without the blessings of corporate management. He also stated that under normal circumstances, senior management or other directors nominate board candidates. Management fully recognizes the power implications of selecting board candidates who will be sympathetic to their needs. The result, Tackett (2004) argued, is often a board whose composition is biased towards the interests of management instead of the stockholders. If senior management can control the composition of the board of directors, then they also control the composition of the audit committees, which erodes their independence.

In addition to independence, audit committee members are required to be financially literate. The Blue Ribbon Committee recommends that all members of the audit committee need to be financially literate. Zabihollah (2003) defined financial literacy as the ability to read and understand fundamental financial statements including balance sheet, income seminars, and flow statements To be an “audit committee financial expert,” an audit committee member must have and diversification of economic and accounting principles, comprehend how financial reporting choices and accounting policies can affect a company’s financial reports, and possess an understanding of internal controls

and procedures. The issue is whether one 'financial expert' is sufficient on an audit committee to understand the nature and impact of complex business transactions such as derivative financial instruments, related party transaction etc. The requirements that only one audit committee member be a financial expert may not be adequate to fulfill effectively the financial oversight function of the audit committee. Jonathan (2001) stated that it is yet to be seen the level at which this financial literacy will finally settle and whether there are enough people who, making the grade, are willing to be members of an audit committee. Jonathan (2001) also wondered whether in a world of ever more complicated accounting standards, which even fully trained accountants can struggle to understand, if this is a completely realistic and necessary requirement for audit committee members. However, Herdman (2002) questioned whether the capital markets requirement about financial literacy of audit committee members went far enough. Some studies have been carried out in the area of experience and expertise. For example, a study by Gao (1991) cited by Joshi (2004) found that approximately half of the 40 surveyed audit committee chairs from large US banks perceived that their audit committees had no members with expertise in assigned accounting, auditing, banking and law oversight domains.

2.2.1.7 Meetings and Agenda

Attwood (1986) stated that in practice the timing of meetings of audit committee needs to be scheduled well in advance in order to fit in with what is northerly a very tight timetable for the production of the company's interim and final accounts. Likewise the audit committee may want to plan meetings with different departments and subsidiaries, so that over a period of years it covers the whole of the areas included in the terms of reference. Guy stated that most audit committees today have two to four scheduled meetings per year depending on the scope of their activities and the size of the company, Graziano (2004) differed with Guy and stated that audit committees are meeting more frequently -both formally and informally. Formal meetings are held at least four, and sometimes up to twelve times per year. Typically, four of the meetings are in person, last about three to four hours and include senior management, external audit and internal auditor (Graziano 2004). Adequate time should be allowed at each meeting so that the agenda can be covered in a professional and complete manner. In addition to scheduled

meetings, the audit committee must have authority to hold special meetings as needed (Guy 2001). Herdman (2002) stated that audit committee members must make the time, and take the time, to achieve an adequate understanding of the company's financial reports, to have time to consult with outside counsel and experts if necessary, to ask the tough and incisive questions, and to obtain answers that make sense. As such Herdman (2002) argued that an effective audit committee requires a commitment of quality and quantity time to allow thorough deliberations and discussions. This means that proper up-front planning, conduct of meetings and follow-up is essential. Research studies involving meeting frequencies of audit committees and company variables have created some interest. Menon and Williams (1994) in a study cited by Joshi (2004) examined 200 companies and found that the number of audit committee meetings increased as the percentage of outside directors increased. Meeting frequency was positively associated with company's size, monitoring and need of audit committee meetings. In its survey of audit committees, Price Water House Coopers (1999) found that audit committees among European companies met on average three to four times a year. The chairperson of the audit committee should prepare the meeting agenda. The chairperson, working with the chief finance officer, the audit manager, and the general counsel, along with input from external auditor, should prepare detailed agenda with topic and time allocations to help keep the committee focused. The chairperson should circulate proposed audit committee's agenda to all committee members to obtain their inputs about topics that should be added. Under no circumstances should management alone prepare the audit committee's agenda. Meeting agenda and related materials should be distributed to committee members in advance of scheduled meetings (Guy 2001)

Attwood (1986) stated that audit committees would find it most useful to keep minutes of its meetings. However, he argued that discussions between the audit committees and senior directors and managers might be inhibited if it takes place in the knowledge that the matters raised will be minute and those minutes circulated. There is also the problem of finding an individual of sufficient seniority and confidentiality to do the minute - taking. Attwood (1986) stated that it is important for the audit committee to decide on the extent to which its minutes are circulated beyond its own membership. Above all, minutes are useful in order to ensure that there is a proper follow up of the matters on

which the audit committee decides that action is needed. The audit committee's report is the basis for reporting on the board of directors' charge to the committee. The report should be addressed to the full board of directors and explain their findings and recommendations concerning primarily the overall effectiveness of both the internal and external auditing functions and other areas within the original jurisdiction as defined in the charter. In addition, the report should be based on their participation in the audit planning process as well as their monitoring activities (Braiotta 1999).

2.2.1.8 Self- evaluation

AICPA (2004) recommended that an audit committee should conduct a comprehensive self- evaluation on an annual basis. The self-evaluation can take different forms, involve a number of participants, and use diverse techniques. Most important, however, the self-evaluation should adopt a straightforward approach that will aid the audit committee in reassessing its strength and weaknesses and lay a foundation for future improvement. It is important that the audit committee evaluate its performance by asking specific questions about the impact it has had on the organization, most importantly, in its financial reporting process, the annual audit, the relationship with the independent auditor, and members of management. The audit committee should include the chair of the board in the evaluation session and ask for his/her input. The evaluation should be comprehensive and should involve all audit committee members and the committee chair .The chair should consider the result of the audit committee member's evaluation of each other in the text of the chairs evaluation of the members. The chair should consider whether any member should be rotated off the committee, and this should be done in consultation with the chair of the board. The member's attendance records and level of participation should be considered during this process.

2.2.1.9 Relationship with Management, Internal Auditor and External Auditor

The Blue Ribbon Committee (1999) stated that quality financial reporting can only be achieved through open and candid communication and close working relationships among the company's board of directors, audit committee, management, internal auditors and the external auditors. The success of audit committees in fulfilling their oversight responsibilities depends on their working relationships with other participants of

corporate governance. Zabihollah (2003) stated that the more effective approach is the audit committee to work diligently with management and auditors to identify the most complex business activities, assess their relative risks, determine their accounting treatment, and obtain complete understanding of their impact on fair presentation of financial performance conditions. Audit committee members should be sufficiently knowledgeable to ask management as well as the internal and external auditor's tough questions regarding quality, transparency, and reliability of financial reports.

Braiotta (1999) stated that it is essential that the audit committees be totally independent from the chief executive officers (CEO). In a study based on an examination of audit committees of 13 companies listed on the New York Stock Exchange (NYSE), M.L. Lordal found that effective audit committees permit the CEO to attend committee meetings on invitation only (Braiotta 1999). The CEO is the best source of information relating to the business and he can ensure quick action on committee requests. In achieving appropriate relationship with the CEO, a key ingredient is the quality of the audit committee chairman. He must have both the sensitivity to know when to bring the CEO into the group's deliberations and the strength to stand up to him when the committee wants to pursue an inquiry or change policy. Terrell (2003) stated that a more effective audit committee is a more focused and informed committee. The audit committee should expect the management to be an integral element in helping it to expand its awareness of the company's financial reporting process, including identifying risks and understanding the controls surrounding those risks. A study by Haka and Chalos (1990) cited by Reinstein (1996), found evidence of agency conflict between management and the audit committee chair.

The interface between the audit committee members and the internal auditing group provides a logical relationship because these groups have common goals. The board of a company is ultimately responsible for its system of internal controls. However, the board will normally delegate to management the task of establishing, operating and monitoring the system. The board should regularly assure itself that appropriate processes are functioning effectively to monitor the risks to which the company is exposed and that the system of internal controls are effective in reducing those risks to an acceptable level. Although the responsibility for reviewing the effectiveness of internal controls lies with

the board of directors, in reality, the board is likely to delegate this task to its audit committee. The role of the audit committee in the review process is for the board to decide and will depend upon factors such as the size, composition of the board, and the nature of the company's principal risks (Zaman 2001). It is important that the audit committee and the internal auditor establish a working relationship that is not counterproductive (Braiotta 1999).

The work of the audit committee and the independent auditors is very closely related because both groups have common objectives regarding the financial affairs. Tackett et al (2004) stated that prior to the Sarbanes-Oxley Act in the USA; it was legal for auditors to report to their clients' management. The Sarbanes-Oxley Act required that auditors report to and are overseen by a company's audit committee. This committee must approve all audit and non-audit services, must receive all new accounting and auditing information from the auditors, and must serve as the official line of communication between the auditor and the client company. Tackett et al (2004) argued that requiring the audit committee to make all decisions about hiring or firing the auditors removes from management the ability to threaten or coerce the auditors with dismissal if the auditors fail to perform in a manner acceptable to management. Also requiring the audit committee to approve all payments made to the auditor for auditing and non-auditing services makes it difficult for management to purchase unneeded consulting services from the auditor with the intent of paying a 'legal bribe' in the hope of getting more favorable treatment from the auditor. Finally, requiring the audit committee to deal with disagreements between the auditor and management on accounting matters makes it difficult for management to prevail on questionable accounting practices. A study by Reinsteih (1996), which surveyed 179 audit committee member audit disputes the audit committee tended to support the auditors rather than management.

2.2.1.10 Challenges in Audit Committees Relationship

The challenge when reporting performance outcomes of shared programs reveals a lack of an effective governance framework that transcends the traditional vertical silos of governance. As a priority, there is a need for frameworks and appropriate reporting mechanisms for shared programs. The British government's "Invest to Save" budget encourages cross-departmental co-operation by providing financial incentives to two or

more agencies to jointly deliver services which are more efficient, innovative, “joined-up” and locally responsive (National Audit Office, 2001). The British government has recognized that the existing system of allocating resources and accounting for budgets is a barrier to joined-up government, and as an alternative, it has introduced a model which emphasizes separate funding to “lead agencies” for priority programs. Budgets are pooled, and funds may be managed by a single agency, though accountability is shared by a group of ministers.

The Auditor General of Canada (2000) has also proposed a framework for collaborative arrangements under which the department designated to lead the management of a horizontal program has the critical role of ensuring that issues are managed in a way that meets the partners' objectives and obligations. The lead department needs to have the necessary power to discharge its responsibilities, to ensure that partners are kept informed, that performance is monitored, and that partners live up to their commitments. Joint initiatives rely on clear expectations, and each of the partners knowing in concrete terms what is expected of them. This requires an up-front framework agreement, and “credible” reporting which depends on the collection and sharing of reliable and compatible data.

In Australia, there is increasing recognition that shared outcomes require broader corporate governance arrangements across government. Barrett (2001) has outlined the concept of “network bureaucracy” or “network governance” as a way to ensure proper integration and co-ordination of joint activities. In his view, a more formal governance framework is required than the traditional bureaucratic model of co-ordination through the establishment of inter-agency task forces or committees. Further, he asserts that if there is no central agency oversight, this can be problematic. There is clearly a growing realization by the Auditor-Generals in these three countries of the benefits of a more collaborative mode of operation. This requires “cultural transformation in government agencies”, and “siloed” organizations need to become more integrated and externally focused. However, as yet, regulators have not moved to incorporate these concerns into their reporting guidelines (Barrett, 2001). Wilkins (2002) canvasses a range of options on how ministers might account to Parliament for “shared” initiatives. One option is for each government department to answer for its own part of the initiative; however, such

“siloes” reporting would be fragmented and it would be difficult to obtain any meaningful information on the impact of the whole program.

A second option is for the head department to take responsibility for reporting. This option may provide integrated reporting, but there is a possibility that the role of partner agencies will be sidelined. A third option is for a non-participating minister to take on a coordinating role, but while this option may provide some impartiality, the minister concerned is made accountable for something for which he/she is not responsible. A fourth option is for the ministers to take collective responsibility. While this may achieve integrated reporting, there is no apparent basis for it, in the Westminster system which emphasizes individual ministerial accountability. A fifth option would be for the premier/treasurer to take responsibility on a whole-of-government basis (Wilkins, 2002).

In summary, it is apparent from the literature on accountability that the tensions which exist between the traditional vertical notions of accountability of governments and newer horizontal solutions being sought for program delivery have only begun to be addressed from a theoretical perspective. Moreover, since the reputation of implementing partners is crucial and it is very difficult to restore it once damaged, it is important to establish mechanisms of trust that are beneficial in order to develop and maintain legitimacy and public trust. Hence, all partners need to be self regulating, with a sense of understanding and self awareness, as well as capable of building trust between, donors and ultimate service consumers.

2.2.2 Accountability Theories

Accountability requires an account of the extent to which the objectives for which the resources were entrusted have been achieved. This accountability is described as a contract between an agent and a principal and arises from a duty upon the agent and the rights of the principal (Gray, et al., 1987). The principal can be entirely passive and this will not matter to the agent whose duty nevertheless is to account - the passive principal is merely waiving his or her rights to the information (Stewart, 1984). On the other hand, it has been argued by Tricker (1983) that the agent only has a duty to account to principals who demand information and are willing to enforce the contract.

Much of the research on corporate accountability suggests that regulation is the only way to ensure that companies provide complete and comparable reports. Gray *et al.* (1987)

suggest a compliance with standards approach, and the proliferation of reporting guidelines mainly on environmental issues. Many academics consider that only mandated, standardized reporting will produce the comprehensive information needed to assess corporations' performance. Support for such a regulated approach is provided by evidence that voluntary disclosure levels are much lower than those for mandated disclosure (Guthrie & Parker, 1990). A more persuasive argument for the use of legislation in making companies more accountable is that social and environmental matters are too complex and crucial to be left entirely in the already over-burdened hands of corporations. Thus, by opening up organizations in order to inform stakeholders, it enables the stakeholders, rather than management of organizations, to express their choices about critical issues. One of the problems associated with reporting against mandatory standards however, is the question of who ensures compliance with those standards and what penalties apply for non-compliance. For implementing agencies it can be argued that accountability should be more focused on accounting for their actions and effects on society, rather than accounting for their financial performance (Bebbington & Gray, 1993).

According to Ebrahim (2003), agency accountability is a dynamic concept and arguably more complex than simply making agents transparent and allowing public scrutiny, which highlights the issue of competing stakeholder interests. Organizations must deal with competing requirements of various stakeholders, and most often choose to satisfy the needs of their primary stakeholders first and often at the expense of secondary stakeholders' needs as their principle goal is aligned with the needs of these primary stakeholders. Brown & Moore (2001) postulate that since agencies are not coherently aligned with one another they must, like other organizations, also prioritize their stakeholders. This can have dire consequences for their existence as their goals to provide welfare may not always be aligned with the goals of their donors.

The issue of multiple stakeholders, while at best making accountability more complex can be additionally problematic for agents because such competing demands can actually lead to poorer performance - satisfying clients and donors can sometimes be in conflict with the organization's long term goals. While this is in some part true for companies also, for donor dependent agents it is the primary goal that is often subverted (Brown &

Moore, 2001). Brown and Moore (2001) suggest that these agents should commit themselves to more accountability to their clients rather than donors. They argue that if they provide assessments of their performance to clients, the clients will only be prepared to talk about problems if donors are not also evaluating the program, for fear of losing future funding if they criticize the program. Ironically however, if they resist the demands for accountability made by funding bodies and donors, they may lose funding anyway.

Slim (2002) in an overview of the agency Accountability literature over a period of ten years, outlines two kinds of accountability for agents: performance accountability and voice accountability. Performance accountability requires agents to be accountable for what they do. This kind of accountability is focused on accountability to donors and clients and is similar to corporate-style accountability that firms have to their primary stakeholders - shareholders and investors - which they discharge via published accounts and other reporting that indicates how much has been spent, what targets were set and whether they have been achieved.

Voice accountability on the other hand, requires agents to be accountable for what they say. That is, they are accountable to an abstract purpose (Brown & Moore, 2001). This form of accountability is similar to what Najam (1996) calls accountability to themselves, where agents are accountable for their goals and aspirations, and for their mission. This requires a different way of thinking about accountability than the corporate-style reporting model that can be applied to performance accountability and a basic conflict appears as demands for greater performance accountability may come at the expense of voice accountability. The task of providing statements of income and expenditure, descriptions of programs, and targets and achievements is less subjective than providing an account of goals and missions.

2.2.3 Stakeholders Theory of Accountability

Creating accountability in public service is extraordinarily complex. There is a complex web of policymakers and providers in such responsibility. The issue of accountability is also complicated by the difficulty in defining and measuring financial outcomes. Extensive research suggests that about two-thirds of the variation in achievement is the product of deliberate neglect and slim commitment to account (Ladd, 1996). The stakeholder theory has been used quite extensively in the management literature since

Freeman's landmark book "Strategic Management: A Stakeholder Approach" was published in 1984. He proposes that current approaches to understanding the business environment fail to take account of a wide range of groups who can affect or are affected by the corporation, its stakeholders. He further argues that in order to manage effectively in turbulent times which typifies the dynamic nature of the business environment of today, the stakeholder theory offers a way to address the ever changing demands brought about by different groups having legitimate stakes of varying degrees from the organization (Jensen & Meckling, 1996).

The basic proposition of the stakeholder theory is that the organization's success in the attainment of accountability standards is dependent upon the successful management of all the relationships that it has with its stakeholders. When viewed as such, the conventional view that success is dependent solely upon maximizing shareholders' wealth is not sufficient because the school entity is a nexus of explicit and implicit contracts. Furthermore, the stakeholder theory assumes that organizations have the ability to influence not just society in general but its various stakeholders in particular. In developing the stakeholder theory, Freeman incorporates the stakeholder concept into categories: planning and policy model; and corporate social responsibility model of stakeholder management (Jensen and Meckling, 1996).

The stakeholder analysis focus on developing and evaluating the approval of the organization's strategic decision by groups whose support is required for continued existence. The stakeholders in this model would include the Government, CDF, Audit Committee target groups and general public. Although these groups are not adversarial in nature, their possibly conflicting behavior is considered a constraint on the strategy developed by management to best match the resources with the environment. In the second model, the corporate planning and analysis extends to include external influences which may be adversarial to the firm. These adversarial groups may include the regulatory, environmentalist and/or special interest groups concerned with social issues. The second model enables organizations to consider a strategic plan that is adaptable to changes in the social demands of nontraditional stakeholder groups (Chan and Kent, 2003).

Due to increased level of awareness there is need for organizations to extend their financial planning, use and reporting to include the non-traditional stakeholders like the regulatory groups in order to adapt to changing demands (O'Donovan, 2002). There is considerable evidence that many organizations need to voluntarily disclose financial information in their periodic/annual reports. However, given that there are substantial costs involved in providing such disclosures and magnified by the fact that reporting is largely unregulated, conventional wisdom suggests that entities would only provide voluntary disclosures when their benefits exceed their cost (Chan and Kent, 2003).

2.3 Dimensional Framework

After conducting an extensive analysis of prior accountability studies, Ullmann (1995) indicated that one of the reasons for the inconsistent findings in previous research is the lack of theory. He argued that accountability models previously developed in prior studies are mis-specified because the relationship between organization strategy and accountability decisions is not included in the empirical tests. He proposed that firms use disclosures as a means to manage their relationships with their stakeholders and the external environment. This is the basic tenet of the stakeholder theory. He then developed a three-dimensional strategic framework consistent with the concept advanced in the stakeholder theory by Freeman.

The three-dimension framework is useful to explain the correlations among disclosures and accountability as well as economic performance. The first dimension, stakeholder power, explains that an institution will be responsive to the intensity of stakeholder demands. For example, when stakeholders control critical resources, the organization is likely to react in a way that satisfies their demands. The second dimension, strategic posture, describes the mode of response the organization is likely to take concerning social demands. Entities employing an active posture try to influence their status by continuously monitoring their position with stakeholders, for example, by initiating social responsibility and accountability programs as well as disclosing their commitment. The third dimension, past and current economic performance, determines the relative weight of a social demand and the attention it receives. This dimension is relevant because it is conceivable that organizations suffering from low accountability may place economic demands ahead of social demands (Chan and Kent, 2003).

2.4 Role Theory of Accountability

Role systems theory was originally seen as a way to describe how organizations manage to inculcate or produce reliable behavior on the part of their members (Katz & Kahn, 1998). Moreover, role theory places a great deal of emphasis on interpersonal relationships. Furthermore, it postulates a central role for interpersonal expectations, emphasizes the importance of the consequence of compliance, and links tasks and activities to individuals (Ferris *et al*, 2000). Besides these striking similarities regarding the structure and functioning of role systems and accountability systems in organizations, the former perspective provides what people feel are important new insights regarding when and where accountability is produced and the organizational systems that are relevant. This seems to be a deficiency in current views of accountability theory. Thus, people feel that a role systems theory perspective adds value to any treatment of accountability in work settings.

At its essence, accountability in organizations can be viewed as involving elements of role taking and role making as these unfold in the context of a history of role episodes. While accountability refers to the building of self-actions-standards perceptions (Schlenker *et al.*, 2004), role theory also deals with such linkages, but in the form of role expectations. Accountability has tended to focus on opinions, decisions or behaviors related to moral or ethical issues (Dose & Klimoski, 2005) as noted, and role theory also has included these as well as issues of a more mundane sort. Moreover, at its base, accountability implies the anticipation of an accounting, having to report or explain oneself to others in the future. In role theory, the focal worker also anticipates facing an accounting as well, in this case, having to respond in the future to the expectations of role senders, albeit, perhaps on shorter and recurring cycles. In many ways, role theory explicates the essential components and relationships central to accountability.

Accountability has largely been one of explaining reactions to anticipated reviews. Thus, Ferris *et al* (2000) describe examples of both the cognitive and behavioral consequences of having to face the expectations of another party. This is almost the essence of role theory. Role theory has proven useful for the explanation of organizations because of its consideration of several factors and dimensions in a unified framework. These factors and dimensions have specific applications to accountability which warrant discussion.

One is that a role theory approach incorporates a multitude of intrapersonal, interpersonal, and person-organization dynamics which help guide our approach to several issues. The framework developed herein suggests that variables, such as general cognitive ability, social intelligence, conscientiousness, generalized efficacy, trait stress, and self-monitoring, among others, may be of particular interest. These variables have specific implications for how individuals approach their environments, which may set the stage for receiving and interpreting environmental cues. Other variables have specific implications for the interpersonal and person-organization aspects of the proposed framework. Variables, such as agreeableness, locus of control, and personal and work values, among others, are related to how one interprets and responds to environmental cues, and might help explain and predict behavior related to accountability perceptions (Patten, 2002).

2.5 Mechanisms for Accountability

Brown and Moore (2001) state that there is no single accountability structure that is right for all organizations. The needs of a transparent and standardized reporting and accounting mechanism for large scale service delivery, conflict with the requirements of providing the services and voice to those in need. Edwards and Hulme (1996) describe the need for standardized delivery mechanisms, structures that can handle large amounts of external funding, and systems for speedy - and often hierarchical -decision making but emphasize that effective performance as an agent of democratization rests on organizational independence, closeness to the poor, representative structures, and a willingness to spend large amounts of time in consciousness-raising and dialogue. Moreover, reporting alone is insufficient, as there must also be access to the information (Neligan, 2003). In view of Ebrahim (2003), NGOs and other agencies already engage in disclosure and reporting by undertaking performance assessment, engaging in community participation and through self-regulation. There are various reporting requirements in law in many countries and these requirements are directed at providing accountability to the public at large and often require quite detailed information about finances, organizational structure and programs. Donors to NGOs also require performance assessments, and often employ experts and impose technical criteria to assess the data collection and analysis for particular programs. The NGOs are in turn accountable respective donors as

a matter of prudence, as a matter of law and as a matter of ordinary morality (Brown & Moore, 2001).

Other than reporting, participation with the community is emphasized by NGOs as an important means of accountability (Cronin & O'Regan, 2002). This can include public meetings, surveys, or a formal dialogue on project options or actual involvement of community members in the project. Finally, self regulation, as described by Ebrahim (2003), is the efforts undertaken by NGOs to develop their own standards or codes of conduct. Thus, many NGOs would suggest that there are already a number of mechanisms in place to assure the public, donors and clients that they are accountable. They might also suggest that their involvement in political engagement itself instills habits of cooperation and public spiritedness within and enhances collaboration and social solidarity outside it (Wapner, 2002).

While NGOs and other agencies might argue existing accountability mechanisms are sufficient, critics could suggest that voluntarism and self-regulation is not effective, and could cite evidence from the corporate world to support this view (Tomaszewski & McCarthy, 2005). Simply having a code does not ensure all organizations will follow the rules. Thus, on the surface, it would appear that some form of mandatory reporting by NGOs forms an ideal measure of accountability. However this too is not without its difficulties. The first problem is the very nature of the reporting. For example, the difficulty in evaluating and measuring what NGOs do given the sometimes very specific nature of work done by particularly smaller organizations (Marshall, 2002). There is no straightforward measure of organizational effectiveness and NGOs have no readily acknowledged bottom line (Fowler, 1996). There are also implicit inclusions of normative principles in setting benchmarks for accountability (Keohane, 2002). Uphoff (1996) suggests that attempts to measure and quantify the work done by NGOs will in fact conflict with the objective of sustainability because is emphasis most often than not put on short-term and measurable benefits, thus overlooking positive externalities, particularly those that will benefit future generations. Similarly, in a report from an aid issues group, it is suggested that NGOs and their projects are treated as closed systems for the sake of analysis yet there may be benefits outside of this closed system (Cronin & O'Regan, 2002).

The second issue is that of enforcement and/or sanctions. Corporations are regulated and, if necessary, penalized by Governments or appointed regulators to report on their activities, both their financial activities via the annual report and accounts, and on other activities via legislation. In addition, social and environmental reporting is mandatory in some countries and even where it is still voluntary, there are many industry codes, charters and other mechanisms that require some reporting. However, regulation by governments of an organization whose most important role is often to counter the power of those governments presents a paradox that is difficult to resolve, particularly when many NGOs work across national borders. The effect, of making NGOs more accountable, on their ability to contribute to society, particularly as a dissenting voice to counterbalance government and corporate actions, is extremely important (Edwards, 2003).

Regulation of reporting has been abused by governments to control NGOs that they consider to be subversive (Ebrahim, 2003). There is thus a political dilemma faced by NGOs, given their goal of giving voice to those less powerful. Transparency of their actions and performance can only make it easier for vested interests to identify and therefore oppose what they are doing. At worst, it could lead to de-registration and closure of the organization for being subversive (Gray, *et al.*, 1987).

2.6 Empirical Review

A number of scholars have shown that the problems of adverse selection and moral hazard exist in the management of diverse outlets. Outlet/agency managers have an incentive to shirk and to misrepresent their abilities since the owner of the firm cannot easily differentiate the effect of manager behavior on outlet performance from the effect of exogenous factors (Brickley and Dark, 1987). Franchising scholars have found that one way that performance of outlets can be enhanced is through the provision of residual claimancy. However, the establishment of a hybrid organizational form does not eliminate all agency costs (LaFontaine and Kauffman, 1994).

Roberts (2002) undertook a study to understand the determinants of corporate social responsibility disclosure using a sample of 80 companies drawn from a population of 130 major companies investigated in 1984, 1985 and 1986 by the Council of Economic Priorities (CEP). Roberts found that his measures of stakeholder power, strategic posture

and economic performance are significantly related to levels of corporate social disclosure. The findings contribute to the knowledge on how organizations should manage their stakeholders using disclosures. However, the extent to which such disclosures are related to accountability remains debatable. For example, numerous studies from the 1980s through to 2000s report either no significant or negative relationship between disclosure and accountability (Patten, 2002).

In another related study, Fogarty (1996) examined accountability standard-setting process and found that institutionalization, through the basis of separated procedures and the formal characteristics of assessment, enables the organizations to achieve tolerable decisional freedom. He further noted that the visibility of its processes, and the consequences of its outcomes, contributed to its critical dependence on legitimacy. Further, he analyzed the peer review process of firms as a mechanism utilized by them seeking to legitimize a largely self-regulatory industry.

Studies by the National Audit Office (2001) regarding accountability practices indicated that accountability for joint expenditure requires the roles and responsibilities of partners, how their performance is to be measured and reported, and the accounting and audit arrangements to ensure propriety over public expenditure all need to be clearly set out and understood.

Finally, a report was undertaken in 2003 on the accountability of international NGOs that investigated access to online information and information on member control of governance for NGOs, inter-governmental organizations (IGOs) and transnational corporations (TNCs). Kovach, et al., (2003) did a report which concluded that international NGOs in the sample provide little online information about their activities compared with other organizations. In particular, the section of the report focusing on access to online information measured accountability by looking for the public accessibility of certain attributes in their reporting and found it lacking. This type of accountability mechanism however, is based on the assumption that accountability is the same for all types of organizations.

2.7 Summary

All the responded to the questionnaire recommended CDF to have audit committee charters where 56 percent recommended annual update of those charters. Eighty nine percent recommended CDF audit committees to conduct meetings with external auditors in prior to the start of the annual audit and review the management letter issued. External and internal auditors should have access the CDF audit committees and 58 percent recommended of audit committees to monitor the extent of non-audit services performed by the external auditors in CDF. All the respondents indicated that their CDF audit committees to be meeting. All CDF audit committees should have a financial expert and all the knowledge, industry experience and financial experts to be effective in their role. The average number of CDF audit committees meetings should be 3.8 per year average 2.2 hours. The audit committee members should be in charge of setting the agenda and should use the charter as a guide to a very large extent. Fifty six percent of CDF audit committee recommended them to be assessing the CDF management performance annually and the CDF stakeholders to be mainly carrying of the CDF assessment. The research identified the gaps created by the absence of audit committees as no any other research has been conducted in this area.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter comprised of the research design, the population of interest, the population sample, data collection instruments and the data analysis technique that were used to establish the role of the audit committees in promoting corporate governance and accountability in constituency development fund management in Nairobi province.

3.2 Research Design

This descriptive survey study was aimed at establishing the role of audit committee in promoting corporate governance and accountability in constituency development fund management (CDF) in Nairobi Province in Kenya. This design was found most appropriate because of data collection using questionnaire and secondary data. Mugenda (2003)

3.3 Target Population and Sample

The population consisted of all CDF office bearers 15 in every constituency CDF office of Nairobi province. The Nairobi constituencies office bearers numbering and target of 80 (eighty) ten from every constituency of Nairobi CDF. 65% of each CDF committee out of the 15 members of CDF committee. This was a good representative of the residents since it was a sizeable population 66% of CDF office bearers representing every constituency population. They were selected from the list of CDF employees of the Constituency Development Fund committee.

3.4 Data Collection

Self-administered drop and pick questionnaires were distributed among senior employees currently employed by the CDF and Nairobi residents. Questionnaire was designed to identify the role the audit committee can play in promoting corporate governance and accountability in the CDF management in Nairobi Province.

The staff in the department includes managers and other senior staff in the ranks of management in the CDF.

Structured questionnaires were used as the main data collection instrument. The questionnaires had both open and close ended questions. The close-ended questions provided more structure response to facilitate tangible recommendations. The open-ended questions provided additional information that could not have been captured in the close-ended questions.

3.5 Data Analysis Procedures

Qualitative data was analyzed using qualitative analysis while SPSS Version 17 was used to analyses the quantitative data. The qualitative analysis was done using content analysis. It involved observation and detailed description of objects, items or things that comprises the sample. Descriptive statistics were used to summarize the data. This included percentages and frequencies tables.

3.6 Reliability and Validity of Primary Data

The reliability and validity of data collected for research were controlled through formulation of relevant research question by considering the research questions that expressed relationship between variables the questions were stated in an unambiguous form and the questions that were tested empirically. The appropriate data collection method were used to suits the study questions and sampling technique that ensured that the sample was representative and minimizes bias.

CHAPTER FOUR

DATA ANALYSIS AND FINDINGS

4.1 Introduction

This chapter set to give a detailed analysis of data collected. Data was collected using the audit committee questionnaire and checked with audit committee reports included in the capital market authority CMA 2008. Collected data was analysed in order of the research questions to achieve the objective of the study.

4.2 General Information about the Respondents

Table 4.2.1 presents data on the number of constituencies in Nairobi having no audit committees and who's respondents wished establishment of the audit committee to instill corporate governance and accountability in the management of CDF.

It can be seen that 49 (89.1 percent) of the 55 respondents recommended for establishments of audit committee in their respective constituencies. The questionnaire was addressed to other CDF management committee ad those who reside in respective constituencies of Nairobi.

Table 4.2.1: Constituencies without audit committees and wished to have one established.

Constituency	No. of respondent target in the sample	No. recommended A.C established	No. not recommended A.C established	Total respondents	Parentage respondents per constituency
Dagoreti	10	5	1	6	60%
Embakasi	10	6	0	6	60%
Kamukunji	10	5	2	7	70%
Kasarani	10	8	0	8	80%
Langata	10	6	0	6	60%
Makadara	10	6	1	7	70%
Starehe	10	7	1	8	80%
Westlands	10	6	1	7	70%
Total	80	49	6	55	68.75%

Source: Research findings

Table 4.2.1 also shows that the respondents are evenly distributed across different constituencies in Nairobi. Ten (12.5 percent) of the respondents were chosen from Nairobi's eight constituencies. All the sample (of ten) respondents did not respond. 6 (7.5 percent) from Dagoreti, Embakasi and Langata 7 (8.75 percent) from Kamukunji, Makadara and Westland's and 8 (10 percent) form Kasarani and Strarehe. 55 (89.1 percent) respondent the questionnaire with 6 (10.9 percent) did not recommend for establishment of audit committee in their respective constituencies.

4.3 The Roles of the Audit Committees

The main responsibility of the audit committees if established, it to oversee the planning CDF projects, appraisals of the CDF projects, receiving feedback of CDF projects, ensuring accountability of CDF projects, ensuring accounting policies are maintained in CDF records, enforcing proper bookkeeping records and persuing CDF project feasibility studies. It is clear from the table 4.3.1 that 93 percent (45.1 + 47.9) of the respondents indicated that the above six roles will be played by the audit committees if established to instill corporate governance and accountability in the management of.

Table 4.3.1: The role audit committee can play in promoting governance and accountability in CDF management

Responses	Respondents degree					Total
	Strongly agree	Agree	Neutral	Disagree	Strongly disagree	
Planning CDF projects	42	10	2	1	0	55
Appraisals of CDF projects	09	41	3	2	0	55
Receiving feedbacks	29	22	1	3	0	55
Accounting Policies adherence	40	13	0	2	0	55
Bookkeeping adequacy	10	42	1	2	0	55
Feasibility	19	30	2	4	0	55
Total	149	158	9	14	0	330
Percentage	45.1	47.9	2.72	4.24	0	100

Source: Research findings

4.4 Responsibility of Audit Committees in enhancing Efficiency and Effectiveness Performance Management

The main responsibilities an audit committee can play in enhancing efficiency and improve management performance in CDF Nairobi Province (if established) scored highly 92.4 percent (28.3 + 61.1) of the respondents in average table 4.4.1 recommended the as follows:- to be vigilant body as an effective overseers of financial reporting processes and internal controls, 91 percent, to review and make recommendations of management programs established to monitor compliance with the code of conduct 91 percent to consider the appointing to the internal auditor 91 percent, to consider the appointing of the internal auditor 91 percent, discuss with external auditor before the audit commences 89 percent, review quarterly half yearly and years ends financial statements 93 percent, review any communication between external auditor and management 91 percent, consider any relate party transactions that may arise within management 92 percent, consider major findings of internal investigations and management responses 92 percent. Have explicit authorities to investigate any matter within the CDF manage 92 percent, have full access of CDF institutions.

Table 4.4.1: Responsibilities of audit committees

Responses	5	4	3	2	1	Total
To be informed and be vigilant and effective overseers of the CDF financial reporting process and internal controls.	20	31	1	3	0	55
To review and make recommendations on CDF management programs established to monitor compliance with the code of conduct	10	41	2	2	0	55
To consider the appointing of the CDF internal auditor	10	41	2	2	0	55
Discuss with the external auditor before the audit commences for CDF project	10	39	3	3	0	55
Review the quarterly, half yearly; and year and CDF financial statements of their consistency	20	33	1	1	0	55
Review and communication between external auditor and CDF management	11	40	2	2	0	55
Consider any related party transaction that may arise within CDF management	10	42	2	2	0	55
Consider major findings of CDF internal investigations and CDF management Responses	40	12	1	2	0	55
Have explicit authority to investigate any matter within the CDF	13	29	1	2	0	55
Have full access to CDF information	23	30	2	1	0	55
Obtain external professional advice and to invite outsiders with relevant experience to attend the CDF projects implementations and evaluation if any.	12	40	2	1	0	55
TOTAL	179	388	16	22	0	605
PERCENTAGE	29.6	64.1	2.6	3.6	0	100

Source: Research findings

To investigate 92 percent obtain external professional advice and to invite outsiders with relevant experience to attend the project implementation and evaluation 92 percent. 2.6 percent were neutral in their view on the role audit can play while 3.6 percent disagreed. Table 4.4.1 clearly indicated that the audit committees can provide non-audit services on top normal audit services. The audit committees should therefore monitor these non-audit services.

4.5 Composition and Membership of Audit Committees

To ensure the independence of the members of the audit committees and to avoid conflict of interest, all audit members should be appointed by the board of directors and not by the management or members of parliament of that constituency. The CMA guidelines required that the audit committee be composed of at least three independent and non executive directors who shall report to the board. Having independent non executive member in the audit committee is a primary and fundamental requirement that was addressed in the trade way report. As recommended by the CMA, all respondents suggested to have three or more members in their respective audit committees.

Table 4.5.1: Number of directors recommended to audit committee in CDF

Number of members	Number of respondents	percentages
3	27	48%
4	14	26%
5	4	7%
6	6	11%
7	2	4%
14	2	4%
TOTAL	55	100%

Source: Research findings

Table 4.5.1 clearly indicates 48 percent of the respondent had suggested less than 3 the minimum number of independent non-executive directors. 48 percent had suggested for 3 non executive more than 3 independent non executive directors.

4.6 Meetings of Audit Committees

Table 4.6.1 Number of meetings of recommended for CDF audit committees

Responses	Number of respondents	Percentages
2	6	11%
3	6	11%
4	35	63%
5	9	0%
6	4	7%
7	0	0%
8	2	4%
9	0	0%
10	0	0%
11	0	0%
12	2	4%
Total	55	100%

Source: Research findings

From table 4.5.3.1 most of the audit committees should meet on average or two hours (85 percent). Eleven percent recommended for three hours while only 4 percent should meet for four hours. The average audit committee meeting should be out of 2.2 hours.

4.7 Recommended Operations of Audit Committees

Most of the questions in the CDF audit committee questionnaire focused on the operations of the audit committees. A detailed analysis of recommended operations of CDF audit committees if established follows below:-

4.8 Establishing Audit Committee Charter and Guidelines

Table 4.5.5.1 indicates recommendations as a good trend that all the 55 respondents (100 percent) should have a developed or CDF audit committees. However in their recommendations, the respondents (56 percent) recommended their charters to be updated annually, while the remaining 44 percent indicated that their update only on a need basis (Table 4.5.5.2) and therefore, not necessarily annually.

Table 4.8.1: Written charters

Responses	Number of respondents	percentages
Yes	55	100%
No	0	0%
Total	55	100%

Source: Research findings

Table 4.8.2: Annual updating of the CDF charter.

Responses	Number of respondents	percentages
Yes	31	56%
No	24	44%
Total	55	100%

Source: Research findings

4.9 Conducting Meetings prior to the start of the Audit

The CDF audit committees should monitor internal and external audit coverage to ensure all key risk areas in CDF are considered. This may involve reviewing and discussing with the auditors the current years CDF audit plan together with the resolution of prior year CDF issues. As indicated in table 4.6.1, 89 percent of the respondents recommended that established CDF audit committees should conduct meetings with the external auditors before the start of the audit. These planning meetings are important as they ensure that the external auditors focus their attention on CDF risky and material sectors of the constituency. However 11 percent indicated the CDF audit committee does not need to conduct any such meetings.

Table 4.9.1: External auditors conducting meetings with CDF audit committee prior to the start of the audit.

Responses	Number of respondents	percentages
Yes	45	89%
No	10	11%
Total	55	100%

Source: Research findings

All the respondents recommended that the CDF audit committees review the management letter issued by the external auditors. This is important as it will result in the audit committees becoming aware of the areas of weakness in CDF and also ensure that the recommendations are promptly implemented.

4.10 Discussion of the Performance of the Finance and Accounting Department

The CDF performance of the finance and accounting department is mainly not the responsibility of CDF audit committees. As indicated in table 4.7.1, only 19 percent recommended of the CDF audit committees to discuss the performance of the accounting and finance department to a very great effect, 41 percent recommended discuss it to a large extent, 26 percent to some extent, while 14 percent don't discuss it at all.

Table 4.10.1 discussion of the performance of accounting and finance department

Extent of discussion	No. respondents	Percentages
To a very large extent	11	19%
To a large extent	22	41%
To some extent	14	26%
Not at all	8	14%
Total	55	100%

Source: Research findings

4.11 Monitoring of the Nature and Extent of Non-audit services performed by the External Auditor by the Audit Committees

When the external auditors provide a lot of other non-audit services on top of normal audit services it may erode their independence. The CDF audit committees as recommended by respondents should therefore monitor these non-audit services. However as fig 4.8.1 recommended 52 respondents recommended of CDF audit committees to monitor these services while 48 percent did not. However all the respondents recommended that the external auditors and the internal auditor should have direct access to the CDF audit committees, which should greatly increase their independence?

Table 4.11.1 audit committees to monitor non-audit services in CDF

Responses	Number of respondents	Percentages
Yes	29	52%
No	26	48%
Total	55	100%

Source: Research findings

4.12 Audit Committees engaging outside Experts

The CDF audit committee should obtain external professional advise and to invite outsiders with relevant experience to attend meetings if necessary. From table 4.9.1 70 percentage of the respondents indicated that the experts should be engaged while 30 percent recommended that they should have never had to engage in CDF corporate governance, though they recommended having the provision in their charters.

Table 4.12.1 CDF audit committees engaging experts

Responses	Number of respondents	Percentage
Yes	39	70%
No	16	30%
Total	55	100%

Source: Research findings

4.13 Audit Committee Reports

Since the CDF audit committee will serve as a guard on the CDF funds assets and projects of stakeholders about the authenticity of funds assets and projects of CDF to the CDF stakeholders. Informative reporting to the boards is a pre-requisite for the committees' effectiveness. No matter how good the work of the audit committee in the CDF will not be able to benefit from their efforts if the CDF boards are not informed of their findings. Lines of reporting between the CDF management board should be formalized, normally within the terms of reference of the CDF audit committees. Regardless of the mode of communication, it is important that the relationships and communication channels between the CDF audit committees and the audit committee reports to the main boards on a regular basis. Through effective reporting the CDF board members will be aware of any issues or disagreements that may have been settled before the accounts are presented for approval.

Table 4.10.1 shows that 89 percent of the respondents recommended report to the CDF stakeholders.

Eleven percent does not recommend CDF audit committees finding to report to stakeholders.

Table 4.13.1 audit committee reporting to the shareholder on its activities and findings

Responses	Number of respondents	Percentages
Yes	49	89%
No	6	11%
Total	55	100%

Source: Research findings

4.14 Relationships with Management Internal Auditor and External Auditor

The CDF audit committee questionnaire included questions to capture the relationships of the CDF audit committees with CDF management, internal auditors and the external auditors. Other questions captured how they will correspond, and how they could resolve any disagreements.

4.15 Extent to which their relationship will be positive

Table 4.15.1 indicates the extent to which the respondents perceived the relationships between the audit committees and the CDF management, internal and external auditors as being positive. As can be seen from the table, 41 percent perceived the relationships to be positive to a very large extent while 59 percent indicated that it was positive to a large extent. This is commendable as audit committees can only be effective when relationship is positive.

Table 4.15.1 nature of relationship with CDF management, internal and external auditor

Extent of relationship	No. of respondents	Percentage
To a very large extent	23	41
To a large extent	32	59
To some extent	0	0
Not at all	0	0
Total	55	100

Source: Research findings

4.16 Independence of Audit Committees

For the CDF audit committees to be effective, it was suggested by respondents that it must be independent and especially resist influence from the CDF management. The CDF audit committees may find it necessary or useful to hold separate private meetings with both the internal and external auditors with no CDF management present. Private meeting(s) would help to ensure a free and frank exchange where the expression of views might otherwise be restricted. Private meeting(s) with CDF management in absence of the auditors can also be helpful. As shown in table 4.16.1 74 percent of the respondents indicated that the CEO board attends audits committee meetings on invitations only while 26 percent indicated that the CEO could attend at will.

Table 4.16.1 CEO attending meetings on invitation only

Responses	No. of respondents	Percentage
Yes	41	74%
No	14	26%
Total	55	100%

Source: Research findings

4.17 Achievement and challenges of CDF audit committees

The achievement of CDF audit committees if established in CDF governance were captured using three questions. There was a question on the influence of CDF audit committees should have on the internal auditors and whether the CDF audit committees will increase reliability of financial statements. There were also open questions on the major achievements and challenges the CDF audit committees likely to face.

4.18 Extents to which audit committees would improve the effectiveness of internal auditors

The performance and efficiency of the CDF internal audit department was suggested to be the responsibility of the CDF audit committees. As indicated on table 4.14.1 seventy six percent of the respondents indicated that the CDF audit committees will improve their efficiency and effectiveness of the internal auditors to a very large extent while 26 percent indicated that the improvement will be to a large extent. Given that the internal audit is one of the key responsibilities of the audit committees, this can be an indicator that CDF audit committee will be achieving their objectives.

Table 4.18.1 having CDF audit committee will improve the efficiency and effectiveness of the internal auditors

Extent of believe	No. respondents	Percentages
To a very large extent	41	76%
To a large extent	14	26%
To some extent	00	0
Not at all		0
Total	55	100

Source: Research findings

4.19 Extent to which CDF audit committees will increase the reliability of financial report

As shown on table 4.14.2 most of the respondents (67 percent) believe that the CDF audit committees will increase the reliability of the financial reports to a very great extent. The remaining (33 percent) indicated that the CDF audit committees will increase the reliability to a large extent.

Table 4.19.1 extent to which CDF audit committees will increase the reliability of financial reports

Extents of believe	No. of respondents	Percentages
To a very large extent	37	67%
To a large extent	18	33%
To some extent	0	0
Not at all	0	0
Total	55	100%

Source: Research findings

4.20 Major Audit Committee Achievements

The major achievement cited by most respondents was to do with the CDF internal audit. Most respondents indicated that CDF audit committees will ensure that issues taken to CDF management will be promptly resolved. This will enhance the independence of the internal audit function. Other achievements suggested included significant improvement in corporate governance practices, improved risk management and control processes clarifying the role of internal audit vis a vis CDF policy setting, forcing CDF management to pay greater attention to internal control, improving CDF tendering system audit hence cutting down on costs.

4.21 Major Challenges likely to face the CDF Audit Committees

Most respondents indicated that there is likely major challenges to CDF audit committees if formed as rapidly changing environment increased local and international regulations, that CDF audit committee will be a new concept and setting its boundaries will be an issue, dominant senior CDF management, chiefs, MP chiefs, influence in CDF management most likely to interfering with work of CDF audit committees if not closely

watched and that they are to be asked to take responsibilities over CDF governance and financial reporting while their involvement should be minimal.

4.22 Reasons why CDF have not established Audit Committees

There was one question on why all CDF management had failed to establish CDF audit committees (all respondents indicated the failure to frequent CDF management they had not adequately internal control measures interference from influential local persons the impact of the MP on CDF management and ignorance of the CMA guidelines.

4.23 Chapter Summary

This chapter has given an analysis of the data collected. Tables, frequencies, percentages and means have been used to summarize the data collected. The analysis is in order of the research questions as indicated in chapter one of what roles the audit committee play in promoting corporate governance and accountability of constituency development fund (CDF) management.

4.24 Discussions

4.24.1 Operations of Audit Committees

From the analysis it was observed that all eight constituencies of Nairobi province have not established audit committees. Neither the location of the constituency nor the size was seen to be determinants of whether a constituency should establish an audit committee or not. In a similar study conducted in Brahmin, Joshi (2004) had concluded that the size of the company and the audit firm whether international or local influence as audits committees in Kenya were established as a result of the CMA guidelines i.e. not voluntarily.

All eight constituencies of Nairobi that responded to the questionnaire did not have literature on the need for audit committee charter. The key is that every constituency should develop a tailor made charter for the audit committee and that every constituency audit committee and that the charter should be updated annually to fit changing environment and fit to changing situations.

Eighty nine percent respondents recommended audit committees to be conducting meetings with the external auditors prior to the start of the annual audit and to review management letter issued. External and internal auditors should have direct access to the

audit committees to monitor the extent of non-audit services performed by the external auditors. Studies that have been undertaken on oversight responsibilities revolved mainly in the areas of financial reporting auditing and overall corporate governance. This was found to be the case in this study.

All the respondents indicated that their audit committees should meet the three minimum number of committee members required by the CMA guidelines with the average number of members being 4.3 per committee. Members and the audit committee chairperson should be appointed their independence from the CDF management. All audit committees should have a financial expert and the audit committee members should have the knowledge, industry experience and financial expertise to be effective in their role. Literature has a lot on the membership of audit committees. The composition of audit committees should depend on the circumstances of a particular constituency. However, there should be an agreement that the members should be independent of CDF management to be able to be effective. A study by Gao (1991) had found that half of the 40 surveyed audit committee chairs from large USA banks perceived that their audit committees had no members with expertise in assigned accounting, auditing, banking and law oversight domains. In this study all the respondents indicated that audit committee should have the knowledge and industrial experience to perform their job.

In this study the average number of meetings should be 3.8 per year where each meeting should take an average 2.2 hours. Literature has it that formal meetings are held at least four and sometimes up to twelve times per year. Typically, four of the meetings are person and last about three to four hours. Price water house coopers (199) found that audit committees among European companies met on average three to four times in a year. It is apparent that audit committees in CDF will do well if established.

The audit committee members should be in charge of setting the agenda and should use the charter as a guide to very large extent. The audit committees should report to the board mainly on a need basis and the board should follow all their recommendations. The audit committee should assess their performance annually and the board should mainly carry out the assessment. In the literature review, it was found out that the chairperson of the audit committee should be in charge of setting the agenda and that of at no time should the management alone prepare the audit committee agenda. To ensure that the

audit committees cover all the areas included in their charter they should use it as a guide when setting the agenda. At the end of every year, they should assess their performance to ascertain how well they have discharged their mandate.

4.24.2 Relationship with Management internal and External Auditors

In this study the relationship with CDF management internal and external auditors should be positive to a large extent. CDF management and auditors should correspond with the audit committee using mail, telephone and e-mail on a need basis. The audit committees should be independent of CDF management and 74 percentages respondent recommended that the CEO's should attend the CDF audit committee meetings on invitation only. Literature has it that the success of audit committees in fulfillment their oversight responsibility depends on their working relationships with the other participants in corporate governance. The CEO should be the best source of information relating to the concern and can ensure quick actions on audit committee request. The chairperson of the CDF audit committee should have the sensitivity to know when to bring the CEO in to the committees' deliberations and the strength to stand up to him when the audit committee wants to pursue an inquiry or change policy. A study in the USA found that effective audit committees permit the CEO to attend its meetings on invitation only which seem to be the case in this study. In another study Haka and Chalos had found evidence of agency conflict between management and the audit committees in CDF corporate governance and accountability in Kenya appear to have been forgotten in this respect as 76 percent indicated that CEOs' should attend audit committee meetings on invitation only. The respondents also indicated that the relationship of audit committees with other players in corporate governance of CDF should be positive. This will ensure that they will be able to achieve their roles and objectives.

4.24.3 Achievements and Challenges of CDF Audit Committees

In this study the major achievement of the audit committee is providing the internal audit with a communication channel ensuring that the audit issues raised by the internal audit are attended to promptly to enhance its independence. Audit committees will also increase the reliability of the financial statement to a very large extent. Literature, however is divided on the achievement of audit committees. A study by Guy (2004)

found out that only 15 percent of executive director's of TTSE 100 companies believe audit committees were vital in order to achieve sound corporate governance. However A/CPA considers audit committees as vital in improving internal controls.

Literature gives the challenges facing a result of their report being included in the many stakeholders. Other challenges include activities additional regularly requirements and greater visibility and expectations of audits committees. Audit committees in CDF will be facing similar challenges as the respondents indicated that the major challenges will be changes in legal and operating environment increased liability and the problem of setting the boundary between the audit committee and the CDF management and the perceived influence the area MP and the councilors have on the CDF management.

4.25 Conclusions

All the listed companies in Nairobi stock exchange (NSE) meet the CMA requirement in terms of the composition membership and independence of audit committee members. CDF in establish audit committee have audit committee charters in order to increase their independence and those of internal and external auditors.

The relationship of the CDF audit communities with CDF managerial internal and external auditors should be cordial to a large extent. For the all constituencies in Nairobi province the reason given was frequent CDF management changes and lack of legal framework. The audit committee is highly likely to promote corporate governance and accountability in management of CDF in not only in Nairobi province but also in Kenya if established in line with CMA guideline.

CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Summaries of Findings

5.1.1 Operations of Audit Committees

From the analysis it was observed that all the eight constituencies of Nairobi province have no established CDF audit committees. All the responded to the questionnaire recommended CDF to have audit committee charters where 56 percent recommended annual update of those charters. Eighty nine percent recommended CDF audit committees to conduct meetings with external auditors in prior to the start of the annual audit and review the management letter issued. External and internal auditors should have access the CDF audit committees and 58 percent recommended of audit committees to monitor the extent of non-audit services performed by the external auditors in CDF. All the respondents indicated that their CDF audit committees to be meeting. The minimum number of committee members as required by CMA guidelines with all of them having an average 4.3 members per committee. Members and the CDF audit committee chairperson should be appointed by the board of directors, which will increase their independence from the CDF management. All CDF audit committees should have a financial expert and all the knowledge, industry experience and financial experts to be effective in their role. The average number of CDF audit committees meetings should be 3.8 per year average 2.2 hours. The audit committee members should be in charge of setting the agenda and should use the charter as a guide to a very large extent. Fifty six percent of CDF audit committee recommended them to be assessing the CDF management performance annually and the CDF stakeholders to be mainly carrying of the CDF assessment.

5.1.2 Relationship with Management Internal Auditors and External Auditor

The relationship with CDF management internal auditor and external auditors will be possible to large extent. CDF management and auditors should correspond with the audit committees using mail, telephone and e-mail on a need basis. The CDF audit committees should be independent of CDF management and 74 percent recommended CEO's to be attending CDF audit committee meeting on invitation.

5.1.3 Achievement and Challenges of Audit Committees

The major achievement of the CDF audit committees should be providing the internal audit with a communication channels ensuring that the audit issues raised by the internal audit are attended to promptly to enhance its independence. CDF audit committees will also increase the reliability of the financial statements to a very large extent. The major challenges anticipated to CDF audit committees' establishment are changes in legal and operating environment problem of setting the boundary between the CDF audit committees and CDF management and control influence of the MP and councilors from the CDF management.

5.1.4 Reasons for not having established Audit Committees in Nairobi province

All the respondents indicated frequent changes in CDF management, lack of proper legal framework on CDF fund management influence of local MP and councilor's lack of string internal control and ignorance of CMA guidelines. As main reasons for not having audit committees in CDF.

5.1.5 The Roles of the Audit Committees in promoting CDF Governance and accountability in Nairobi Province

Majority of respondents to the audit committee questionnaire gave the following as the main roles to be played by audit committee to promote governance and accountability to oversee the planning of CDF projects appraisals receiving feedbacks, ensuring accountability, accounting policies CDF projects and carrying out project feasibility studies.

5.1.6 Responsibilities of Audit Committees in enhancing Efficiency and Effective Management

Most respondents (92 percent) recommended the following as the main responsibilities of audit committees towards enhancing efficiency and management in CDF Nairobi province; to be vigilant body as an overseer of internal control, reviewing and making recommendations on CDF management programs and monitor compliance with the code of conduct consider the appointment of the internal auditors, discuss with external auditors before the audit commerce reviewing quarterly, half-yearly and year-ends financial statement review any communication between external auditors and CDF

management consider major findings of internal investigations and CDF management responses, have explicit authority to investigate any matter within the CDF management have full access to information obtain external professional advice and invite outsiders with relevant experiences to attend the CDF project implementation and evaluation.

5.2 Recommendations

The role of audit committees in promoting corporate governance and accountability in CDF management in Nairobi province appear to highly recommendable. Audit committees can enhance CDF performance would greatly improve the relationships among the major players in corporate governance.

However, this can be enhanced if audit committees and CDF management eliminate perceived power influence of MP's and legal framework of CDF management seem to be relying mainly on the work and assurances given by others.

The CMA guidelines require companies to indicate in the annual report whether they have an audit committee and the mandate of the committee. All the Nairobi province CDF should have one or two paragraphs on audit committees in their annual reports. These reports should strive to give maximum information as required by CMA guidelines and enable instill corporate governance and accountability in management of CDF in Nairobi province.

5.3 Limitations

This was an empirical study which means that it had a broad coverage but shallow depth. An in-depth examination Kenyan 210 constituencies. Only eight constituencies of Nairobi province where chosen for that study. Also out of the eighty (80) respondents chosen only 55 responded to the questionnaire. However this was not a major limitation as the respondents did not exhibit significant variations. CDF chairpersons completed none of the questionnaires. This means that their side of the story was not captured in the analysis. Some respondent chose to mislead by giving wrong answers others ignored some had no idea on audit committee on CDF.

5.4 Direction for Further Research

Future research may be directed to the role of audit committees Kenyan constituencies outside Nairobi province. Further studies could be carried out to examine the effect of audit committees on audit remunerations (fees). Additionally there are some encouraging findings regarding the reduced likelihood of financial reporting problems when audit committees are more active and more independent but much more need to be discovered about how the audit committees influence the financial reporting quality. Lastly, the more presence of non-executive directors in the audit committees in terms of their power effects and effectiveness and the role of independence non-executive directors in promoting corporate governance and accountability.

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APPENDICES

APPENDIX I: LETTER OF INTRODUCTION

Dear Respondent,

REF: REQUEST FOR RESEARCH DATA

I am a postgraduate student at the University of Nairobi, pursuing a course leading to a Masters degree in Business Administration (MBA). In a partial fulfillment of the requirements of the stated course, I am conducting a Management Research Project on a **survey of the role of the audit committee in promoting corporate governance and accountability in constituency development fund (CDF) management in Nairobi Province.**

To achieve this, your constituency is one of those selected to participate in this study. I therefore kindly request you to fill the attached questionnaire to generate data required for this study. This information will be used purely for academic purpose and your name and that of your constituency will not be mentioned anywhere in the report. Findings of the study, shall upon request, be availed to you. Your assistance and cooperation will be highly appreciated.

Yours truly,

Mokaya N. Oriku
D61 / 72030 / 2008
Researcher/ Student
University of Nairobi
Nairobi

APPENDIX II:QUESTIONNAIRE

CDF Audit Committee Questionnaire

1. Name of the constituency (optional)? _____
2. Is there an audit committee in your constituency?
Yes []
No []
3. Are the functions of the audit committee performed by another body?
Yes []
No []
Please specify the other body _____
4. How many members should you recommend to compose your CDF audit committees?

(Write the number)
5. Who should appoint the chair of the audit committee?
CDF board []
CDF executive office []
MP []
Councilors []
Other, (please specify) _____
6. If your CDF does not have an audit committee or equipment, please give reason (s)
1. _____
2. _____
7. The audit committee can play a great role in promoting governance and accountability of CDF management in your constituency.

Do you agree with this statement? Please indicate the role using appropriate scale

5. Strongly agree 4. Agree 3. Neutral
 2. Disagree 1. Strongly disagree

Roles	5	4	3	2	1
Assist in planning CDF projects					
Appraisals of CDF projects					
Receiving feedbacks on CDF projects					
Accountability standards in CDF					
Maintenance of accounting policies					
Ensuring proper bookkeeping enforcement					
Pursuing CDF projects feasibility studies					
Any other please specify					

8. “The audit committee has a number of purposes in enhancing governance and accountability in your constituency development fund management” do you agree? Please indicate the roles using appropriate scale, 5. Strongly agree 4. Agree 3. Neutral 2. Disagree 1. Strongly disagree

	Purposes	5	4	3	2	1
(i)	Vigilant and effective overseers of the CDF financial reporting process and internal controls					
(ii)	To review and make recommendations on CDF management programs for compliance with code of conduct					
(iii)	Consider e appointing of CDF internal auditor.					
(iv)	Discuss with the external auditor before the audit commences.					
(v)	Quarterly, half-yearly and year end review of CDF financial statements.					
(vi)	Review any communication between external auditor(s) and CDF management.					
(vii)	Consider major findings of CDF internal investigations and CDF management responses					
(viii)	Consider any related party transactions that may arise within the CDF management					
(ix)	Have explicit authority to investigation ay matter within CDF					
(x)	Have full access to CDF information.					
(xi)	Obtain external; professional advice and to invite outsiders with relevant experience to attend the CDF projects implementation and evaluation if necessary.					
	Any other please specify					
	(i) _____					
	(ii) _____					

9. Should the audit committees responsibilities defined in a charter?
Yes []
No []
10. If yes, should the charter be update annually and approve by the board of director?
Yes []
No []
11. Should the chair of the audit committee be an independent non-executive? director?
Yes []
No []
12. Should audit committee members have knowledge in the field of accounting and finance?
Yes []
No []
13. Should audit committee members have knowledge, industry experience and and financial expertise to serve effectively in their role?
Yes []
No []
14. Should audit committee members engage outside experts as appropriate?
Yes []
No []
15. How many times should he audit committee meet in your constituency?
_____ (write number)
16. How long should the average audit committee meeting take in hours? _____
17. Should audit committee be in charge of setting the agenda of its meetings?
Yes []
No []
18. Should audit committee report to CDF stakeholders on its activities and findings?
Yes []
No []

19. How often should he audit committee report to the board?

Annually

Semi annually

Quarterly

After every committee meeting

Other (please specify) _____

20. Should the CDF most recent report include a reference to the audit committee.

Yes

No

21. Should the audit committee assess its performance annually?

Yes

No

22. Should the audit committee have a positive relationship with CDF management
the internal auditors and he independent auditors?

To a very large extent

To a large extent

To some extent

Not at all

23. Should the audit committee have a positive relationship with CDF management
the internal auditors and the independent auditors?.

Mail

e-mail

Telephone

Other pleas specify

24. Should the CDF chief executive officer attend audit committee meeting on
invitation only?

Yes

No

25. Should there be procedures in place for reporting the audit committee significant deficiency and material weakness in a timely manner?

Yes []

No []

26. Should the disagreements between the CDF management and outside auditors reported timely to the audit committee.

Yes []

No []

27. Should the audit committee members independent of CDF management?

Yes []

No []

28. Should the audit committee constructively challenge managements planned decisions, particularly in the are of financial reporting?

Yes []

No []

29. Should difference of opinion on accounting policies always resolve ed to the satisfaction of the audit committee?

Yes []

No []

30. To what extent to you believe that having an audit committee in your CDF will improve efficiency and effectiveness of the internal controls?

To a very large extent []

To a large extent []

To some extent []

Not at all []

31. What are the likely major achievements of the audit committee in your constituency development fund..

32. What are likely to be the major challenges to face the audit committee in your constituency?

33. Any other comments on the functioning of audit committees and its role in promoting corporate governance.

Thank you for your time and cooperation

APPENDIX III: LIST OF EIGHT CONSTITUENCIES OF NAIROBI

1. Dagoretti
2. Embakasi
3. Kamukunji
4. Kasarani
5. Langata
6. Makadara
7. Starehe
8. Westlands