EFFECT OF AUDIT COMMITTEE CHARACTERISTICS ON FINANCIAL PERFORMANCE OF COMPANIES LISTED AT THE NAIROBI SECURITIES EXCHANGE

By

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DECLARATION

This Research Project is my original work and has not been presented for an award of a degree in any other university or institution of learning.

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This Research Project has been submitted for examination with my approval as the University supervisor.

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DEDICATION

This research project is dedicated to my father Mr. Bildad Ngachira, for his good parental guidance and discipline which has made me whom I am today.

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ABSTRACT

The composition and character of the audit committee play significant role in influencing quality of an organization performance. However, very few studies have addressed or even shown how audit committee composition and character influence firm performance in developing countries such as Kenya. This research aims at establishing the effect of audit committee characteristics on firm performance among listed firms in Nairobi securities exchange, Kenya. To establish the effect of audit committee size on firm performance, to ascertain the impact of the number of independent auditors on firm performance, to determine the effect of audit committee gender diversity on firm performance and establish the effect of audit committee experience on firm performance. The study uses the agency theory and institutional theory. This study adopted an explanatory design. The study was conducted in firms listed on the Nairobi Securities Exchange for the period ranging from 2006 to 2011. The study thus utilized data from 46 companies as the other 14 companies had either been recently listed or had inconsistently traded in the NSE. Descriptive statistics such as means, standard deviation, frequencies and percentage were used to analyze data. In addition, Multiple Regressions was used because of its ability to use multiple independent variables to estimate their effect on a single dependent variable. Research findings showed that audit committee experience, committee gender diversity, audit committee size and number of independent auditors has a significant effect on firm performance. The presence of audit members with experience will also reduce financial misreporting and enhance quality monitoring. As such, having experienced audit committee members should be a key priority for firms. Also an increase in the number of female members bring on board a wide array of experiences and talents there is need to increase the proportion of independent auditors since an increase in their number reduces the chances of financial misreporting and leads to positive perception by investors there is need for firms to have an audit committee that is not too small such that there is lack of expert advice and not too large such that it has free riders that are prone to follow other members opinion

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ABBREVIATIONS

AC	Audit committee
AICPA	American Institute of Certified Public Accountants
AIMS	Alternative Investment Market Segment
BRC	Blue Ribbon Commission
CEO	Chief Executive Officer
CMA	Capital Market Authority
DAC	Discretionary Accruals
GDP	Growth Domestic Product
MIMS	Main Investment Market Segment
NEDs	Non-Executive Directors
NSE	Nairobi Security Exchange
ROA	Return on Asset
SEC	Securities and Exchange Commission
SOX	Sarbanes-Oxley Act (2002)
USA	United State of America

CHAPTER ONE

INTRODUCTION

1.1 Background to the Study

Financial performance has implications to organization's health and ultimately its survival. The Firms' management effectiveness and efficiency in making use of company's resources is highly reflected by high financial performance and this in turn contributes to the country's economy at large (Naser & Mokhtar, 2004). Company performance is very essential to management and other stakeholders such as shareholders, debt holders and the government as it is an outcome which has been achieved by an individual or a group of individuals in an organization related to its authority and responsibility in achieving the goal legally, not against the law and conforming to the morale and ethic (Iswatia, & Anshoria, 2007).

A growing stream of research suggests that audit committee characteristics are critically important to the role effectiveness of audit committees (Abbott et al., 2003). Commentators emphasize the need for audit committees to be comprised of members who are independent, including some of whom to possess financial expertise and for the audit committee to meet frequently (Carcello et al., 2002; Abbott et al., 2004). The evidence in this area of research is unclear, however board and audit committee expertise has been shown to enhance firm value (Chan and Li, 2008; Bronson et al., 2009). Research on audit committee diligence, which refers to the frequency in which audit committees meet, has been shown to have a potentially positive impact on firm performance (Raghunandan and Rama, 2007; Sharma et al., 2009). According to Abbott et al. (2004), audit committees that meet at least twice a year will decrease the potentiality of misleading and fraudulent reporting.

This study is anchored within the agency theory; the empirical studies increasingly recognize that audit committees have a central role in reducing agency problems (Zahra, Pearce 1989). Agency theory argues that the delegation of managerial responsibilities by principals (owners) and agents (managers) requires the presence of mechanisms that either align the interests of principals and agents or monitor the performance of managers to ensure that they use their delegated powers in the best interests of the principals. It has been argued that weak internal or external auditing, controlling and limited protection of minority shareholders intensify the traditional principal agent problems in transitioning economies (Dharwadkar et al.2000).

1.1.1 Audit Committee Characteristics

The concept of audit committees differ according to the goals, functions, and responsibilities assigned to them. Al-Thuneibat, (2006) defined the audit committee as the committee that is composed of non-executive directors in the establishment.

The major goal behind forming the audit committee is to increase auditing quality and questioning of board of directors. Arens et al (2009) defines it as a group of persons selected from members of the board of directors who are responsible for retaining independence of the auditor. The study of Saleh, et al., (2007) attempted to evaluate the role of some qualities of the audit committee with regard to independence of committee members, its size, and frequency of meetings, in addition to the experience and knowledge which members of the committee have to monitor management behavior.

1.1.2 Financial Performance

The concept of firm performance implies measuring the results of a firm's policies and operations in monetary terms. These results are reflected in the firm's return on investment, return on assets, and net profit after tax etc. Performance differences in firms are often the subject of academic research and government analysis (Verreynne and Meyer 2008). The underlying motivation for this kind of research is the quest for those factors that may provide firms with a competitive advantage and hence drive firm profitability.

However, despite the attention for and importance of the topic, defining a specific industry has always been a subject of discussion. It is likely that average performance differs among different competitive arenas or businesses within an industry just as the average performance differs among industries. By considering businesses instead of the industry as the primary unit of analysis, researchers may gain a more in-depth knowledge of the rivalry patterns between firms and drivers of performance (Houthoofd 2006). One of the major discussions in strategy concerns the determinants of firm performance. Academics from various backgrounds have focused on explaining firm performance and on identifying the sources of inter-firm performance differences (Chang 2000).

However, despite the importance of these issues, assessing the relative impact of audit committee size, number of independent auditors, audit committee gender diversity and audit committee experience on performance has received scant empirical study. Furthermore, these issues have only been seldom addressed within the context of NSE firms (Chang and Singh, 2000).

1.1.3 Relationship Between Audit Committee Characteristics and Firm Financial Performance

The former Chairman of the Securities and Exchange Commission (SEC) knows as Arthur Levitt in the USA mentioned that effective oversight of the financial reporting process depends largely on strong audit committees and qualified, committed, independent and tough-minded audit committees represent the most reliable guardians of the public interest; Bronson *et al.* (2009). In view of the added responsibilities assigned to audit committees, these characteristics have become even more significant, although previous research has not provided any answers on how much of the aforementioned factors is enough to ensure effective committees or how their effectiveness should be measured (DeZoort *et al.*, 2002).

Studies carried out in developed economies such as India often argue that the auditing system in it is comprehensive and is thoroughly backed by the law in order to maintain the impartiality, objectivity and independence of statutory auditing process. Unfortunately, it has been observed over the time that the auditing system in India has become susceptible to various types of accounting manipulations, irregularities and leakages; therefore, harming the interests of investors and other stakeholders. Ganguli,

(2001) despite these findings the study continues to point fingers on the non-conformance of desired audit characteristics in formulation of effective audit committee. Therefore, this research will try to establish the link between audit committee characteristics in developing economy such as Kenya and how it influences the firm's financial performance.

1.1.4 Nairobi Securities Exchange

The operations of audit committees in a developing country may differ when compared to practices in developed countries. This study attempts to understand, how audit committees operate in developing countries, the challenges they face and their effect on financial performance for companies listed on the Nairobi securities exchange.

The Kenyan Capital Market Authority (CMA) issued guidelines on corporate governance practices for publicly listed companies in 2002. One of the guidelines requires the board to establish an audit committee with at least three independent and non-executive directors (Legal notice No 60 CMA, 2002). In Kenya the independence of most directors may be affected by the fact that most of them serve as directors of more than one listed company leading to conflict of interest especially if the companies involved buy and sell goods from each other. This is mainly attributed to the shortage of skilled human resources in Kenya. Moreover some of the listed companies are small, making it difficult for them to attract qualified people hence ultimately affecting financial performance.

1.2 Research Problem

Firms listed in NSE provide an important alternative source of long-term finance for long-term productive investments. This helps in diffusing stresses on the banking system by matching long-term investments with long-term capital. They provide equity capital and infrastructure development capital that has strong socio-economic benefits - roads, water and sewer systems, housing, energy, telecommunications, public transport etc.

This makes the capital market ideal for financing through capital long dated bonds and asset backed securities. Also provides avenues for investment opportunities that encourage a thrift culture critical in increasing domestic savings and investment ratios that are essential for rapid industrialization. The Savings and investment ratios are too low, below 10% of GDP (CMA, 2010).

Corporate governance literature always argue that audit committee participates, not only in the process whereby management disseminate information to the auditors and releasing unbiased information reducing information asymmetry between insiders and outsiders; but also play an important role in ensuring that statutory auditors are not in the influence of management, therefore audit committees can be used as a mechanism to reduce agency problems faced by firms, (Jensen and Meckling, 1976), The composition and character of the audit committee play significant role in influencing quality of an organization performance Cadbury, 1995).

In the midst of recent economic downturn, increased demand for good corporate governance and accountability (Braiotta 2004) and additional regulations have increased the WorldCom was partly due to “a number of deficiencies in the performance of the audit committee and the internal audit activity”. Vicknair *et al.*, (1993). Several studies and reports have emphasized that the audit committees characteristics and composition to consist of independent non-executive directors, who are less likely to be influenced by the management and therefore get desired financial performance.

Previous studies in developed economies such as Kenya disclosed a challenge that many audit committee members do not possess the necessary skills, knowledge and experience to act as audit committee members and perform their duties optimally Cascarino & Van Esch (2005); it also revealed the existence of management challenge to an apparent lack of available non-executive directors (NEDs) with the required business acumen and accounting background who are willing to serve on audit committees Njunga (2000). However, very few studies have addressed or even shown how audit committee composition and character influence firm’s financial performance in developing countries such as Kenya. Therefore this research study will seek to establish the effect of audit committee characteristics to firm financial performance in the Nairobi securities exchange.

1.3 Objectives of the Study

To establish the effect of audit committee characteristics on firm financial performance among listed firms in Nairobi securities exchange.

1.4 Value of the Study

Researchers have argued that a good audit committee is not only defined by the qualities of its auditors but the contribution they bring towards general financial performance. Therefore this study will give a lot of insight to investors when making informed investment decisions. Besides the investors, this study will be of great benefit to the management when deciding on the amount of resources to be allocated to ensure the existence of an effective audit committee.

The selection of an effective audit committee is based on policies laid down by the management; this study will assist in the formulation of effective policies that will ensure the selection and appointment of an effective audit committee based on desirable characteristics. Audit committee members are said to be the agents to the owners of the firms who are expected to act with the intent of giving a fair and objective view. This study will give a basis of judging the performance of the firms audit committee in relation to their contribution to overall organization financial performance. In addition to the extant literature on audit committee characteristics in most developed nations, the finding from this study will shed more light on the attributes of the audit committee in developing economies such as Kenya.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter is intended to acquaint the reader with existing studies carried out in the area of audit committee characteristics and their effect on firm performance. The chapter will highlight the relationship between audit committee characteristics and firm financial performance; it will also entail theories of the study and the conceptual framework.

2.2 Theoretical Framework

2.2.1. The Agency Theory

The separation of ownership and control in modern business creates conflicts of interest between managers and stakeholders. Following this conflict was between the principal and the agent, companies are obliged to use control mechanisms to reduce agency costs and information asymmetry like the audit committees (Kalbers & al 1998). Similarly Pincus & al (1989) argues that audit committees are used primarily in situations where agency costs are high to improve the quality of information flows from the agent to the principal. According to the agency theory, to ensure the effectiveness of an audit committee, managers are encouraged to prepare financial statements adequately to specify the return generated by the companies.

Beasley (1996) and Felo & al (2003) based on the agency theory provide for the existence of a positive and significant relationship between the presence of an audit committee and the quality of financial statements. Similarly Mc Mullen (1996), based on the agency theory, finds a positive relationship between the existence of an audit committee and the reliability of financial statements. The agency theory states that the presence of an audit committee within the board of directors is sufficient to ensure the reliability of financial statements. However, Beasley (1996) concluded that the mere presence of an audit committee does not necessarily mean that this committee is effective in performing its oversight role.

2.2.2 The Institutional Theory

In addition to work focused on agency theory, many research on audit committees have relied on an institutional perspective (Scott 1995 and Zaman 2002). The principle of institutional theory is defined by the fact that an organization consists of cultural, social and symbolic that constitutes its broader institutional environment (DiMaggio& al 1983). The adoption and the operation of audit committees were discussed based on this perspective to the extent it suggests that the audit committee can influence and be influenced by a multiplicity of agents (Zaman2002).

Similarly Zaman (2002) states that this perspective can enhance the role of professional bodies and the promotion of regulatory audit committees. In this regard to better perform the function of monitoring and control efficiently, which some authors Klein (2002) and Bryan &al (2004) have stressed the importance of certain characteristics related to the members that form the audit committee.

Likewise, the report Vienot (1995) provides that the audit committee's main task is "to ensure the relevance and consistency of the accounting policies adopted for the consolidated financial statements and the company's social and verifies that the internal procedures for collecting and monitoring information guarantee them. In the same furrow, Spira (2003) states that the audit committee has the ultimate aim of defending the interests of investors and reduce agency problems of companies characterized by informational asymmetries. In addition, Spira (2003) showed that the audit committee is an effective body to protect the interests of shareholders and ensure the reliability of information disclosed.

2.3 Determinants of Firm Performance

Based on Almajali et al (2012) study in Jordan the study examined how financial and non-financial factors, such as leverage, liquidity, company size and company age, have an influence on the firms' financial performance. Almajali et al (2012) chose these factors because they can be easily measured using the data in the financial statements.

Gupta et al (2010) cited some studies showing contradictory results about the relationship between increased uses of debt in capital structure and firms performance. Ghosh, Nag and Sirmans (2000), Berger and Bonaccorsi di Patti (2006) reported a positive relationship between leverage and financial performance, while Gleason et al (2000), Simerly and Li (2000) showed negative relationship between firms performance and leverage level.

A study by Ibrahim (2009) based on a sample of non-financial Egyptian listed firms from 1997 to 2005 reveals that capital structure choice decision, in general terms, has a weak-to-no impact on firm's performance. According to Simerly and Li (2000), there is vast literature available that examines relationship of capital structure and performance of firms in developed nations but very less has been tested empirically for developing and emerging economies. Liargovas and Skandalis (2008) reported that with high level of liquidity a firm will be able to deal with unexpected contingencies and to cope with its obligations during periods of low earnings. Almajali et al (2012) found that there is significant statistical impact of liquidity on Financial Performance of insurance companies. The result suggested that the insurance companies should increase the current assets and decrease current liabilities because the positive relationship between the liquidity and financial performance. In contrast to the above reasoning, based on a theoretical model by Jovanovic (1989), suggest that a moderate amount of liquidity may propel entrepreneurial performance, but that an abundance of liquidity may do more harm than good. Therefore, they concluded that the effect of liquidity on firms' financial performance is ambiguous.

Almajali et al (2012) argues that the size of the firm affects its financial performance in many ways. Large firms can exploit economies of scale thus being more efficient compared to small firms. In addition, small firms may have less power than large firms; hence they may find it difficult to compete with the large firms particularly in highly competitive markets. On the other hand, as firms become larger, they might suffer from inefficiencies, leading to inferior financial performance. Theory, therefore, is equivocal on the precise relationship between size and performance (Majumdar, 1997).

Almajali et al (2012) found that the age of company has no effect on financial performance. New companies shouldn't pay attention to age because of the negative relationship between age of company and financial performance. Loderer et al, (2009) found that there is a positive and significant relationship between the age of a company and its profitability as measured by ROA. Similarly, Swiss Re (2008) indicated that larger firms are found to grow faster than smaller and younger firms found to grow faster than older firms. In contrast, Al-Shami (2008) found no significant statistical relation between age and profitability of firm.

Pastor and Veronesi (2003) report that profitability and market-to-book ratios decline with firm age as investors learn and uncertainty declines. Consistent with that, the variability of stock returns is negatively related with incorporation age (Adams, Almeida, and Ferreira, 2005) and with listing age (Cheng, 2008). It could also be that older firms are incapable of solving collective action problems. As in the case of nations (Olson, 1982), firms might increasingly become organizations of rent-seeking factions as they get older. On balance, it is therefore unclear whether aging helps firms prosper or whether it dooms them.

2.4 Empirical Review

Anderson et al, (2004), for example, found that smaller boards are associated with higher quality monitoring. He shows that companies with smaller boards could shape the CEO for a better more disciplined in the case of poor performance, to give executives a lower level of total compensation and is also associated with higher market valuation. Similarly the expectation that the problem cannot be prevented; increased the effective function of the large audit committee to spot potential problems in financial reporting. In addition, if the size of a team is large, individual members may be more vulnerable to the pressures and more subject to follow the others' opinion without giving another argument. In this case, the audit committee members are not likely willing to question the potential errors in the accounting reports of the internal review process, which in turn can lead to a greater chance of presenting again later.

Conversely a small team will facilitate the exchange of information in the firm and a better discussion between members, to assist management to identify potential errors in financial reporting and reduce the incidence of restatement of the minimum size requirements. A large committee may suffer from the problem of free riders, From previous studies; the performance of the audit committee was determined by the number of audit committee members. These variables have been tested in previous studies conducted by (Xie *et al.*, 2003).

The results showed that the size of the audit committee and to devote more resources is more likely to oversee financial reporting and internal control systems within a firm hence high performance (Anderson et al, 2004.) and facilitate discussions between the audit committee members (DeZoort and Salterio, 2001). Empirical evidence shows that companies with greater audit committee size prefer to suspicious auditor switches (Archambeault and DeZoort, 2001) and more likely to have lower costs of debt (Anderson et. Al, 2004) Since the exchange, the effect now requires their registrants to have at least three directors on the audit committee, hence a strong relationship between audit committee size and firm performance.

Sharma *et al.* (2009) found evidence that the number of AC meetings is negatively associated with multiple directorships, audit committee independence and an independent AC chair. They find a positive association between the higher risk of financial misreporting and AC size, institutional and managerial ownership, financial expertise and independence of the board. Hence it is argued that the number of members on the audit committee and number of meetings can potentially have a positive impact on firm performance.

Similarly Pincus show that firms with larger audit committees are expected to devote greater resources to monitor the process of “reporting” accounting and finance. In the same furrow, Anderson & al (2004) found that large size audit committees can protect and control the process of accounting and finance with respect to small committees by introducing greater transparency with respect shareholders and creditors which has a positive impact on the financial performance of the company

A study done by the Carcello and Neal (1999), found that the likelihood of financial distress a company received with the going concern opinion from the auditors is lower when the percentage of outside director is bigger in the formation of audit committee, it means that the independence of the audit committee can help the external auditor to maintain their fiduciary duty without influence from the director. Another research by them found that a positive relationship between independence of audit committee and financial reporting quality; suggested that having the independence of director in audit committee can enhance the firm performance.

Abbott *et al.* (2000) show that firms with audit committees which are composed of independent directors and which meet at least twice per year are less likely to be sanctioned for fraudulent or misleading reporting. Audit committee independence affects companies' earnings, management and also investors' perceptions.

Klein (2002) indicates that reductions in audit committee independence are accompanied by large increases in abnormal accruals. Raghunandan and Rama (2004) document that good audit committees can affect shareholder perceptions related to the auditor, particularly in those situations where shareholders might perceive an increased threat to auditor independence. However the issue of audit committee independence is no longer popular today because the new stock exchange rules now require that all members of the audit committee be independent (SEC, 2002). Mustafa and Meier (2006) in their study show that the percentage of independent members in audit committees and the average tenure of audit committee members are significantly and negatively related to the incidence of misappropriation of assets in publicly held companies in both the random and the matched models while the number of audit committee meetings is not significant.

Harrast and Olsen (2007) indicate that the audit committees gain significant clout under SOX and have greater power to participate in the financial reporting process if they are independent. Raghunandan and Rama (2007) show that there are more audit committee meetings in firms that are larger, have high outsider block-holdings, are in litigious industries, or have more board meetings and greater independence in their work.

Consistent with this argument, a study of Anderson *et al.* (2004) showed that the cost of debt is reduced while increasing audit committee experience; shown to improve the performance of the company to reduce debt. Xieet.al. (2003) found that the number of negative audit meetings related to discretionary accruals (DAC). The topic of audit committee financial expertise has been widely discussed by accounting researchers. Questions were also raised by public investors whether the exchange requirements of financial reporting and financial expertise of audit committee members have been well addressed (SEC, 2002). Raghunandan *et al.* (2001) find that committees comprised of at least one member having an accounting or finance background are more likely to have longer meetings with the chief internal auditor; provide private access to the chief internal auditor; and review internal audit proposals and results of internal auditing. Likewise, the financial expertise of audit committee may also affect audit services

Abbott *et al.* (2003) document that audit committee financial expertise is significantly, positively associated with audit fees. Information content of audit committee financial expertise has already been documented. Defond *et al.* (2005) claim that a positive market reaction to the appointment of financial experts assigned to audit committees is found however, there is no reaction to non-financial experts assigned to audit committees. Davidson *et al.* (2004) show significant positive stock price reaction when new members of audit committees have financial expertise.

Archambeault *et al.* (2008) find that there is a predicted positive relation between short-term incentive compensation (short-term stock option grants) for audit committee members and likelihood of restatement. The presence of audit committee financial expertise could help the company from fraud prevention and therefore improve firm performance.

In Australia, the ACGPR explicitly requires that the AC include members who are all financially literate in that they are able to read and understand financial statements and at least one member should have relevant experience and education qualifications (i.e. qualified accountant or another finance professional with experience of financial and accounting matters) and that some members should have an understanding of the firm's industry (Australian Securities Exchange Corporate Governance Council 2007). Recent research confirms that accounting expertise within boards that are characterized by strong governance contributes to greater monitoring by the AC and leads to enhanced conservatism (Krishnan and Visvanathan 2008).

The literature separates managerial experience from governance experience i.e. serving on other ACs or boards. Having experienced members on the AC contributes to significantly less misreporting and more effective monitoring (Raghunandan and Rama 2007). Greater independent director experience and greater audit knowledge results in more reliable reports (DeZoort 1998) The empirical evidence indicates that markets react more positively to the appointment of a new AC member who is an expert (Davidson *et al.*2004; DeFond *et al.* 2005). Within the AC, the chair fulfills a key leadership role and hence should be the most qualified person on the AC. Where the AC chair has sufficient auditing background, it is very likely that the AC chair and the CFO will form a good working relationship. Although it is recognized that the chair of AC should have experience, Vafeas (2003) finds contrary evidence that 76% of AC chair's do not have any auditing experience. While experience arguably contributes to AC effectiveness, when AC members have multiple directorships they can be overstretched and will not fulfill their fiduciary duties effectively. Consequently AC effectiveness is negatively impacted the more directorships AC members hold (Vafeas 2003).

The study by Bedard & al (2004) states that there are three aspects to the expertise of the members of audit committees namely: financial expertise, the expertise of government and finally the specific expertise in of the firm. Similarly, Dezoort & al (2001) have found that the amount of experience of audit committee members as well as their knowledge of auditing is positively associated with the likelihood that members support the listener in the discussion of the managerial firm.

Braiotta (1999) provides that members of the audit committee must have some skills in accounting and related fields. Likewise Price Waterhouse indicates that the expertise of the members of the Audit Committee in the field of accounting and finance is a key element of the effectiveness of this committee. Similarly Dezoort& al (2002) require that audit committees consist of at least three independent members whose one of them has a high level of expertise in accounting and finance

Li and Wearing (2004) documented that female nonexecutive directors in the audit committee are at a disadvantage in gaining promotions to positions such as chair of the audit committee. It is likely that audit committees with one or more female directors would function differently than audit committees with all male directors. However few studies have examined the impact of gender differences on audit committee characteristics.

Dennis and Kunkel (2004) argue that female audit committee members in general are more competent, active/potent, emotionally stable, rational, independent, and less hostile than are male managers. For this reason, a female audit committee member may be more sensitive for firm's potential fraudulent financial reporting. Bernardi and several coauthors (2002 to 2010) examined various issues associated with female audit committee members. Bernardi *et al.* (2002, 2005) found that corporations were more likely to include pictures of the board in their annual reports when the membership of their audit committee board included women (2002) and/or minorities (2005). Bernardi *et al.*, also found that corporations with higher percentages of women on their boards were more likely to be on 100 best companies to work for (2006) and most ethical companies (2009) lists; have a higher percentage of female executives (2004); and, engage in activities demonstrating corporate social responsibility hence high firm performance (2010).

Gender diversity on the audit committee boards associates with financial performance (Carter et *al.*, 2008), reduction in the inherent risk (Ittonen et *al.*, 2007), positive market reactions (Defond et *al.*, 2005), and positive cumulative abnormal returns (Huang *et al.*, 2011). These authors note that women were less likely to have attendance problems and that having females on audit committee boards results in better attendance by male directors. Clearly, the female influence in this area is quite important; increasing attendance should result in better audit committee boardroom discussion and higher levels of effectiveness. An increased membership of female directors in the audit committee positively associated enhanced corporate reputation and therefore high firm performance (Bear et *al.*, 2010).

2.5 Summary of Literature Review

Research in developed countries has revealed that good corporate governance may reduce fraudulent earnings management (Rezaee et al, 2003). Indeed the failure of most of the high profile companies has been attributed to the lack of vigilant oversight by their board of directors. Although Africa has not witnessed the level of corporate failure experienced elsewhere, it should be able to learn from some of the experiences (Okeahalem, 2004). Unfortunately, empirical research on the effectiveness of corporate governance in Africa is almost nonexistent. Mangema and Chamisa (2008) have observed that due to the country differences in Africa, it is desirable that various governance structures be examined separately in each country. This study attempts to bridge this apparent gap in prior research by contributing to our understanding of the operations and achievements of audit committees in Kenya.

A number of surveys and empirical tests have been carried out on the functioning and role of audit committees in various countries. For example, in Canada, Maingant and Zeghal (2000) investigated the motives, composition, selection, and frequency of audit committee meetings, audit committee's relationship with internal and external auditors and its broader role. In the USA, Abbot, Parker and Peters (2002) addressed the impact of certain audit committee characteristics identified by the Blue Ribbon Committee (Braiotta 1999) on improving the effectiveness of corporate audit committee and the likelihood of financial misstatement.

Previous studies in developing countries have not addressed the issue of how audit committee characteristics relate to firm performance. This study seek to fill this gap in the literature by investigating how audit committees characteristics in Kenya relate to firm performance

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Research Design

This study adopted an explanatory design. Explanatory research can be defined as a method or style of research in which the principal objective is to know and understand the trait and mechanisms of the relationship and association between the independent and dependent variable. According to Cooper and Schindler (2003), an explanatory study uses theories or hypotheses to account for the forces that caused a certain phenomenon to occur. They further say that it goes beyond description and attempts to explain the reasons for the phenomenon.

Panneerselvam (2004) also argues that an explanatory study analyses the cause effect relationship between two or more variables. This study sought to establish whether audit committee characteristics can have an influence on firm performance. Quantitative data relating to audit committee size, gender diversity, number of independent directors and audit committee experience of Kenyan firms listed in the stock exchange was collected over the past six (8) years from 2006 to 2013 annual reports

3.2 The Target Population

The study was conducted on firms listed on the Nairobi Securities Exchange for the period ranging from 2008 to 2013. An analysis on the annual reports of listed companies (NSE's, Main Investment Market segment (MIMS) and Alternative Investment Market Segment (AIMS) companies) in the NSE was done. These companies must have been trading actively and consistently (not suspended) for at least six (6) years. Firms in the study only included companies in MIMS and AIMS. The total population for the study was 60 companies listed in the appendix.

3.3 Sample Design

Out of the 60 listed companies, the study comprised those that have been consistently trading for the study period (that is from 2008 – 2013). This was to eliminate the problem of missing data which will violate the precision and completeness principle. The study thus utilized data from 46 companies as the other 14 companies had either been recently listed or had inconsistently traded in the NSE. The distribution of the companies utilized for the study was as follows: Seven (7) agricultural, seven (7) commercial and services, twelve (12); banking and insurance, five (5); construction and allied, one (1) telecommunications & technology, two (2); automobile and accessories, four (4); alternative investment sector, three (3); energy & petroleum and five (5); manufacturing.

3.4 Data Collection

This study utilized secondary data and data was collected by use of content analysis which was obtained from the annual financial statements reports of listed firms, annual investors' reports, magazine and articles related to the financial performance of listed firms. Content-analysis consists of analyzing the contents of documentary materials such as books, magazines, newspapers and the contents of all other verbal materials which can be either spoken or printed (Kothari, 2004). For the researcher to get systematic information, documentary guide was used. This study adopted content analysis approach. Content analysis has been selected for this study because it has been widely used in empirical studies and accounting research, particularly in corporate disclosure studies (Berreta and Bozzolan, 2004; Mohobbot, 2005; Hussainey and Elzahar, 2012). It is a research technique for making replicable and valid inferences from texts (or other meaningful matter) to the contexts of their use (Krippendorff, 2004, pp 18) as cited by Nan Jiang (2009). Further, content analysis is a rich source of data as it can establish relationships that are otherwise difficult to be revealed and replicated (Linsley and Shrives, 2006).

A document analysis guide was prepared to enable and guide collection of data on firm and audit committee characteristics of the selected listed companies. According to Oso and Onen (2005), document analysis is an instrument for collecting unobtrusive information. Document analysis was used because data being collected is secondary in nature.

3.5 Data Analysis

Since the data was quantitative and the aim was to establish the degree of association and cause effect relationship between the variables, statistical analysis; descriptive, correlation, multiple regression and analysis of variance was used to address the objectives of the study. Descriptive statistics was used to test the normality of the data collected.

Multiple Regressions was used because of its ability to use multiple independent variables to estimate their effect on a single dependent variable. This would predict a single dependent variable from any number of independent variables entered into regression equations. Blalock (1999) states that "if there are a large number of interval-scale variables that are interrelated, it will be possible to predict any particular variable from any combination of the others'. The study thus used the technique to examine the effect of audit committee characteristics on financial performance.

The hypothesis was tested at 0.05 level of significance (95 confidence level)

The regression model which assumed linearity, normality, constant and independence was

$$Y= \beta_0+ \beta_{1it}X_{1it}+ \beta_{2\,it}\, X_{2it}+ \beta_{\,3it}X_{3it}+ \beta_{4it}X_{4it} + \beta_{5it}\, X_{5it} + \beta_{6it}X_{6it} + \beta_{7it}X_{7it} + \beta_{8it}X_{8it} + \acute{\varepsilon}$$

Y = The dependent variable (firm performance measured as return on assets

$\beta_{0\,=}$ Constant

β_1, β_2, β_3, β_4, β_5, $\beta_{6,}$ $\beta_{7,}$ β_{8-} will be the regression coefficients in Y by each variable of X

$X_1 =$ Audit committee experience

$X_2 =$ Audit committee gender diversity

$X_3 =$ Number of independent auditors

$X_4 =$ Audit committee size

X_5-$X_8 =$ Control variables such as Board size, Firm size, Board tenure, CEO duality

ε = Error

CHAPTER FOUR

DATA PRESENTATION, ANALYSIS AND INTERPRETATION

4.0 Introduction

This chapter presents results of this study based on the formulated objectives and hypotheses as presented in chapter one. This chapter sought to establish the effect of audit committee characteristics on firm financial performance among listed firms in Nairobi securities exchange. The information collected was presented in tabular format. Discussions of the findings were given in under the information presented. The information analyzed was interpreted in relation to the research objectives. Hypothesis is also tested with the study accepting or failing to accept them depending on the p values and t test value.

4.1 Agriculture Sector

Findings in table 4.1 showed that companies in the agricultural sector have an audit committee experience of 10 years (mean = 10.2775). In the sector, committee gender was at mean of 1.44.The results also revealed that the audit committee was composed of 6 members (mean = 6) with 75% of them being independent auditors (mean = 0.7533). Further, most of the firms CEO and chairperson were playing different roles (mean = 0.3043). Board size had mean of 5.9154 with the Board having a tenure of 2 years (mean = 2.7407).

Table 4.1 Agriculture Sector

	Min	Max	Mean	Std. Deviation	Skewness	Kurtosis
Audit committee experience	2	19.27	10.2775	5.27065	0.306	-1.011
Committee Gender	0	4	1.44	1.68523	0.595	-1.489
Number of independent auditors	0.13	0.99	0.7533	0.16504	-2.062	5.842
Audit committee size	3	11	6	2.46982	0.528	-0.978
CEO duality	0	1	0.3043	0.47047	0.911	-1.291
Board size	4.76	6.98	5.9154	0.73426	-0.503	-1.147
Board tenure	1	4	2.7407	0.76423	-0.625	0.568

4.2 Automobile

Study in table 4.2 indicated that the audit committee had an experience of 14 years (mean = 14.8078).Committee gender was at a mean of 2.1111 which was higher than in the agricultural sector an indication of gender parity in the automobile sector. The board was composed of an average of 7 members with 27% of them being independent auditors (mean = 0.2778).There was no firm exercising CEO duality. Further, firm size had a mean ratio of 6.6448.

Table 4.2 Automobile

	Min	Max	Mean	Std. Deviation	Skewness	Kurtosis
Audit committee experience	4.44	16.47	14.8078	7.04608	0.242	-1.586
Committee Gender	2	3	2.1111	0.32338	0.706	0.977
Number of independent auditors	0	1	0.2778	0.46089	1.085	-0.942
Audit committee size	6	12	7.8333	1.61791	1.615	1.8
Board size	4	17	13.9444	1.76476	-0.122	-1.212
CEO duality	0	0	0	0	.	.
Board tenure	6.06	8.16	6.6448	0.55224	1.719	2.572

4.3 Banking Sector

Findings in table 4.3 illustrated that the audit committee had an experience of 11 years (mean = 11.5285). Committee gender was at mean of 2.The audit committee had 13 members (mean = 13.9455) with 79% of them being independent auditors (mean = 0.7964). More results revealed that 16% of the firms in the banking sector had CEO acting as CEO and chairperson at the same time. Average firm size ratio for was reported to be 7.1203 and CEOs had a tenure of 2 years (mean = 2.4727).

Table 4.3 Banking Sector

	Min	Max	Mean	Std. Deviation	Skewness	Kurtosis
Audit committee experience	4.18	13	11.5285	6.45291	-0.41	-1.031
Committee Gender	0	4	2	1.27657	0.055	-1.273
Number of independent auditors	0.13	0.9	0.7964	0.18248	-2.544	6.212
Audit committee size	6	16	13.9455	1.25341	-0.772	0.5
Board size	5	15	10.2727	2.37623	-0.398	-0.147
CEO duality	0	1	0.1636	0.37335	1.87	1.551
Firm size	4.04	8.89	7.1203	1.24041	-1.04	-0.088
Board tenure	1	4	2.4727	0.79009	-0.141	-0.365

4.4 Commercial Sector

As depicted in table 4.4, the audit committee had an experience of 11 years (mean = 11.9407).Committee gender was at a mean of 0.9778 lower than that in agricultural and automobile sector. The board was composed of 9 members (mean = 9.4222). The Audit committee was 12 members (mean = 12.3556) with 78% of them being independent auditors (mean = 0.7839). Further in the findings, it was revealed that 15% of the firms in the sector had CEO duality. Firm size ratio was 5.7735 and CEOs had a tenure of 2 years (mean =2.7778).

Table 4.4 Commercial Sector

	Min	Max	Mean	Std. Deviation	Skewness	Kurtosis
Audit committee experience	4.58	15.19	11.9407	4.65155	-0.583	0.524
Committee Gender	0	5	0.9778	1.25207	1.57	2.087
Number of independent auditors	0.4	0.99	0.7839	0.12394	-0.914	0.129
Audit committee size	11	16	12.3556	1.04785	1.704	4.982
Board size	4	16	9.4222	3.63374	-0.158	-1.375
CEO duality	0	1	0.1556	0.36653	1.967	1.954
Firm Size	3.58	8.67	5.7735	1.4109	0.02	-0.87
Board Tenure	1	6	2.7778	0.97442	0.317	1.826

4.5 Construction

Study results in table 4.5 revealed that the audit committee had an experience of 12 years (mean = 12.8981).There was gender bias in the construction sector as evidenced by a mean of 0.4872.The board was composed of an average of 8 board members (mean = 8.6923) with 15% of the firms having CEOs acting as the chairperson. Minimum board members were 5 while maximum board members were 13.The audit committee was composed of 13 members (mean = 13.8462) with 65% of them being independent auditors (mean = 0.6582).Firm size indicated an average ratio of 6.1773 with CEOs having a tenure of 2 years (mean = 2.7949).

Table 4.5 Construction

	Min	Max	Mean	Std. Deviation	Skewness	Kurtosis
Audit committee experience	4.33	16.58	12.8981	6.35973	0.77	-0.777
Committee Gender	0	2	0.4872	0.68333	1.092	0.008
Number of independent auditors	0.03	0.93	0.6582	0.24005	-1.235	0.666
Audit committee size	11	19	13.8462	2.41201	0.57	-0.491
Board size	5	13	8.6923	2.23788	0.066	-0.85
CEO duality	0	1	0.1538	0.36552	1.996	2.09
Firm size	4.17	7.98	6.1773	1.09451	-0.653	-0.57
Board tenure	1	4	2.7949	0.89382	-0.504	-0.277

4.6 Energy

In table 4.6, findings showed that the audit committee had an experience of 11 years(mean = 11.1536).Committee gender mean ratio was 2.The audit committee was composed of 4 members (mean = 4.7885) with 77% of them being independent auditors (mean = 0.7739)The board for energy sector comprised of an average of 8 board members and 24% CEO duality. Firm size mean ratio was 7.4918 and CEOs had a tenure of 2 years (mean = 2.6538).

Table 4.6 Energy

	Min	Max	Mean	Std. Deviation	Skewness	Kurtosis
Audit committee experience	4.6	15.25	11.1536	7.38366	0.528	-1.019
Committee Gender	0	5	2	1.34536	0.754	0.292
Number of independent auditors	0.56	0.92	0.7739	0.13337	-0.341	-1.202
Audit committee size	4	6	4.7885	1.21797	-0.47	-0.288
Board size	3	13	8.7692	2.77572	-0.544	-0.184
CEO duality	0	1	0.24	0.43589	1.297	-0.354
Firm size	6.79	8.37	7.4918	0.3817	0.275	0.081
Board tenure	1	4	2.6538	0.89184	-0.689	-0.122

4.7 Insurance

Finding from table 4.7 indicated that the audit committee had an experience of 14 years (mean = 14.2085).Committee gender was at mean of 0.7778.The audit committee was made up of 4 members (mean = 4.9074) with 72% of them being independent auditors (mean = 0.7269).The average board size in insurance sector was 9 members with only 3.7% CEO duality. Firm size ratio was 7.152 and CEOs had tenure of 2 years.

Table 4.7 Insurance

	Min	Max	Mean	Std. Deviation	Skewness	Kurtosis
Audit committee experience	6.91	19.79	14.2085	4.40203	-0.281	-1.577
Committee Gender	0	2	0.7778	0.75107	0.399	-1.064
Number of independent auditors	0.52	0.92	0.7269	0.11064	0.199	-0.87
Audit committee size	4	7	4.9074	1.35899	-0.683	-0.008
Board size	6	13	9.6923	1.59422	0.101	0.803
CEO duality	0	1	0.037	0.19245	5.196	27
Firm size	6.08	8.18	7.152	0.65891	-0.328	-1.067
Board tenure	1	4	2.7778	0.84732	-0.359	-0.209

4.8 Investment

Findings in table 4.8 illustrated that the audit committee had an experience of 7 years (mean =7.2085).Committee gender was at a mean of 0.7778.The audit committee was composed of 4 members (mean = 4.9074) with 80% of them being independent auditors (mean = 0.8).Investment sector had board size of 9 members with 3.7% CEO duality. The least board members were 6 while maximum number was 13. Firm size in the investment sector was at a mean ratio of 7.152 with CEOs having tenure of 2 years.

Table 4.8 Investment

	Min	Max	Mean	Std. Deviation	Skewness	Kurtosis
Audit committee experience	6.91	9.79	7.2085	4.40203	-0.281	-1.577
Committee Gender	0	2	0.7778	0.75107	0.399	-1.064
Number of independent auditors	0.6	0.98	0.8	0.11249	-0.322	-0.666
Audit committee size	4	7	4.9074	1.35899	-0.683	-0.008
board size	6	13	9.6923	1.59422	0.101	0.803
CEO duality	0	1	0.037	0.19245	5.196	27
Firm size	6.08	8.18	7.152	0.65891	-0.328	-1.067
Board tenure	1	4	2.7778	0.84732	-0.359	-0.209

4.9 Manufacturing

In table 4.9, findings on the manufacturing sector were demonstrated. Results from the table revealed that the audit committee had an experience of 11 years (mean = 11.4351).Committee gender was at a mean of 1.1875.The audit committee was made up of 12 members (mean = 12.5313) with 77% of the members being independent auditors (mean = 0.7788).The board for manufacturing sector comprised of an average of 12 board members. The least number of members were 7 and the maximum was 15.There were no CEOs acting as the CEO and the chairperson at the same time. Firm size mean ratio was 6.7647 and CEOs had a tenure of 2 years (mean = 2.75).

Table 4.9 Manufacturing

	Min	Max	Mean	Std. Deviation	Skewness	Kurtosis
Audit committee experience	5.33	13.73	11.4351	3.69581	-1.111	4.381
Committee Gender	0	4	1.1875	1.33047	0.686	-0.8
Number of independent auditors	0.09	0.93	0.7788	0.158	-2.275	7.477
Audit committee size	13	17	12.5313	2.24304	0.596	-0.699
Board size	7	15	12.0938	1.95695	-0.057	0.235
CEO duality	0	0	0	0	.	.
Firm size	0	8.16	6.7647	1.30089	-4.784	25.397
Board tenure	1	6	2.75	1.016	0.738	2.285

4.10 All Sectors

Study findings in table 4.10 illustrated the results in all the sectors. Results in table 4.10 revealed that the audit committee experience for all sectors was 11 years (mean = 11.997). Committee gender mean ratio was 1.2007.The audit committee was composed of 13 members (mean = 13.407) with 44% of them being independent auditors (mean = 13.4704).The average board size for firms in NSE is 9 members with 14% CEO duality. The average ratio for firm size among all listed firms in NSE was 6.5566 and CEO tenure was 2 years (mean = 2.7108).

Table 4.10 All Sectors

	Min	Max	Mean	Std. Deviation	Skewness	Kurtosis
Audit committee experience	40.18	69.27	11.997	6.27248	-0.067	-0.497
Committee Gender	0	5	1.2007	1.28261	0.915	-0.151
Number of independent auditors	0.4	0.47	0.44	0.03742	-0.374	-2.8
Audit committee size	8	14	13.4704	2.47717	0.908	1.039
board size	3	16	9.2587	2.8598	-0.102	-0.582
CEO duality	0	1	0.1439	0.35156	2.04	2.178
Firm size	0	8.89	6.5566	1.25838	-1.426	4.17
Board tenure	1	6	2.7108	0.93681	0.221	0.987

4.11 Correlation Results

Correlation analysis is a technique of assessing the relationship between variables: audit committee experience, committee gender, number of independent directors, audit committee size board size, CEO duality, firm size, board tenure and firm performance. Thus, the study analyzed the relationships that are inherent among the independent and dependent variables. The results regarding this were summarized and presented in Table 4.11.

From the results, the most significant relationship exists between committee gender and firm performance with a correlation coefficient value of 0.501 (significant at $\alpha = 0.01$) which indicates that gender contributes up to 50.1% of the change in firm performance. Also, audit committee experience was shown to contribute 31% of the change in firm performance as indicated by the correlation coefficient value of 0.310 which is significant at $\alpha = 0.01$.

The number of independent auditors was negatively correlated to firm performance as indicated by correlation coefficient value of -0.258 indicating that independent auditors was a significant factor contributing 25.8% negative relationship with firm performance .Further, audit committee size was also negatively correlated to firm performance as evidenced by correlation coefficient value of -0.193 (significant at α = 0.01) an indication of 19.3% negative relationship with firm performance. Firm size was also shown to be negatively correlated to firm performance as shown with a correlation coefficient value of -0.136 which indicates that the firm size accounts for 13.6% change in the firm performance(significant at α = 0.05).

CEO duality was negatively correlated to firm performance as evidenced by correlation coefficient value of -0.205 an indication of 20.5% negative relationship with firm performance (significant at α = 0.05). Furthermore, the inter-independent factor correlation showed that 39.1% of the change in firm performance was significantly accounted for by board tenure as shown by correlation coefficient value of 0.391 (significant at α = 0.01).

Table 4.11 Correlation Results

	Firm performance	Audit committee experience	Committee gender	Number of independent auditors	Audit committee size	board size	CEO duality	Firm size	Board tenure
Firm performance	1								
Audit committee experience	.310**	1							
Committee gender	.501**	-0.041	1						
Number of independent auditors	-0.258*	-.124*	.382**	1					
Audit committee size	-.193**	.165**	-.267**	-.381**	1				
Board size	-0.098	0.067	.304**	.455**	0.048	1			
CEO duality	-0.205*	0.017	-.139*	-0.111	0.062	-.399**	1		
Firm size	-.136*	-0.063	-0.057	.171**	0.003	.121*	-0.054	1	
Board tenure	.391**	.173**	.178**	0.031	-0.092	0.008	-0.033	-0.003	1

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

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

4.12 Control Effect

Study findings in table 4.12 revealed that 20.2 percent variation of firm performance is explained by board tenure, board size, firm size and CEO duality as supported by R^2 = 0.202. Durbin Watson test showed that there was no autocorrelation among the variable as indicated by Durbin Watson value =1.687 which was less than 2 thumb rule.

Table 4.12 Control Effect

R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
.450a	0.202	0.191	4.29043	1.687

a Predictors: (Constant), board tenure, board size, firm size, CEO duality
b Dependent Variable: firm performance

4.13 ANOVA Table for Control Effect

Study results in table 4.13 revealed that F value 17.707, with p value = 0.000 significant at 0.05, this implies that the joint prediction of aforementioned independent variables of firm performance is significant. This shows that the model can be used in future to predict firm performance. Moreover, findings showed non-existence of multi-collinearity.

Table 4.13 ANOVA Table for Control Effect

	Sum of Squares	Df	Mean Square	F	Sig.
Regression	1303.764	4	325.941	17.707	.000b
Residual	5135.763	279	18.408		
Total	6439.527	283			

a Dependent Variable: firm performance
b Predictors: (Constant), CEO tenure, board size, firm size, CEO duality

4.14 Control Effect

The results showed that board size had a significant effect on firm performance (β_1= -0.172, ρ>0.05) thus the hypothesis was not accepted. The t-value was -2.928 which showed that board size was less than the amount of variation contributed by the error due to it.

Furthermore, the results in table 4.14 show that CEO duality had significant and negative effect on firm performance (β_2= -0.168, ρ>0.05). Thus the hypothesis was denied. The effect of CEO duality is stated by the t-value = -2.874 which implies that the effect contributed by the estimated parameter related to CEO duality is less than that contributed by the error associated with the parameter.

The findings showed that Firm size had significant effect on firm performance (β_3 = -0.102, ρ<0.05). Thus the hypothesis was rejected. This indicates that there is a change of firm performance by 0.102 units with an increase in firm size. In addition, the effect of Firm size is stated by the t-value = -1.895 which implies that the effect contributed by the estimated parameter related to Firm size is less than that contributed by the error associated with the parameter.

The study showed that board tenure had significant and negative effect on firm performance (β_4 = 0.386, ρ<0.05). Therefore, the study rejected the hypothesis. This indicates that there is an increase in firm performance by 0.386 units with an increase in board tenure. In addition, the effect of board tenure is stated by the t-value = 7.206 which implies that the effect contributed by the estimated parameter related to board tenure is more than that contributed by the error associated with the parameter.

Finally, the VIF for all the estimated parameters were found to be less than 4 indicating the absence of multi-collinearity and thus the variation contributed by each of the independent variables was significant and all the factors should be included in the regression model.

Table 4.14 Control Effect

	Unstandardized Coefficients		Standardized Coefficients			Collinearity Statistics	
	B	**Std. Error**	**Beta**	**T**	**Sig.**	**Tolerance**	**VIF**
(Constant)	1.991	1.8		1.106	0.27		
Board size	-0.287	0.098	-0.172	-2.928	0.004	0.825	1.212
CEO duality	-2.272	0.791	-0.168	-2.874	0.004	0.840	1.191
Firm size	-0.407	0.215	-0.102	-1.895	0.059	0.979	1.022
Board tenure	1.968	0.273	0.386	7.206	0.000	0.998	1.002

a Dependent Variable: firm performance

4.15 Direct Effect

Also, audit committee experience, committee gender, number of independent auditors and audit committee size explained 45.3% variation of firm performance. This showed that considering the independent variables, there is a probability of firm performance (R squared = 0.453). The Durbin Watson value of 1.743 was within the thumb rule of 2 thus no autocorrelation.

Table 4.15 Direct Effect

R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
.673a	0.453	0.446	3.64077	1.743

a Predictors: (Constant), Audit committee experience, Committee gender, Number of independent auditors, Audit committee size
b Dependent Variable: firm performance

4.16 ANOVA for Direct Effect

Study results in table 4.16 revealed that F value 57.86, with p value = 0.000 significant at 0.05, this implies that the joint prediction of audit committee experience, committee gender, number of independent auditors and audit committee size is significant. This shows that the model can be used in future to predict firm performance.

Table 4.16 ANOVA for Direct Effect

	Sum of Squares	Df	Mean Square	F	Sig.
Regression	3067.792	4	766.948	57.86	.000
Residual	3698.212	279	13.255		
Total	6766.004	283			

a Dependent Variable: firm performance
b Predictors: (Constant), Audit committee experience, Committee gender, Number of independent auditors, Audit committee size

4.17 Direct Effect

The regression results presented in Table 4.17 highlights both the direct effect. From the table, audit committee experience showed a positive and significant effect on firm performance (β= 0.331, ρ<0.05).Specifically an increase in audit committee experience by 0.331 units, leads to an increase in firm performance by the same unit. The t-value = 7.351 which implies that it is more than the standard error.

Moreover, committee gender diversity showed a positive and significant effect on firm performance (β= 0.579, ρ<0.05).Consequently, an increase in committee gender diversity by 0.579 units leads to an increase in firm performance by the same unit. The t-value is more than the error associated with as evidenced by t-value = 11.963.

Furthermore, the number of independent auditors showed a negative and significant effect on firm performance (β= -0.318, ρ<0.05).This is a clear indication of 0.318 unit decrease in firm performance once the number of independent auditors is increased. The t-value = -6.287 which indicates that the standard error associated with it is more than it.

Likewise, audit committee size showed a negative and significant effect on firm performance (β= -0.213, ρ<0.05).Consequently, an increase in audit committee size by 0.213 units leads to a decrease in firm performance by the same unit. The t-value is more than the error associated with as evidenced by t-value = -4.366.Finally, the VIF for all parameters were less than 4 signifying lack of multi-Collinearity.

Table 4.17 Direct Effect

	Unstandardized Coefficients		Standardized Coefficients			Collinearity Statistics	
	B	Std. Error	Beta	T	Sig.	Tolerance	VIF
(Constant)	-9.894	2.048		-4.831	0		
Audit committee experience	0.259	0.035	0.331	7.351	0.00	0.968	1.033
Committee Gender	2.207	0.185	0.579	11.963	0.00	0.836	1.196
Number of independent auditors	-1.165	0.185	-0.318	-6.287	0.00	0.765	1.307
Audit committee size	-0.419	0.096	-0.213	-4.366	0.00	0.824	1.214

a Dependent Variable: firm performance

CHAPTER FIVE

SUMMARY OF FINDINGS, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter was divided into three major sections; summary, conclusions and recommendations. These divisions were informed by the purpose, objectives study and the results of the study.

5.2 Summary of Findings

The study was carried out to establish the effect of audit committee characteristics on firm financial performance among listed firms in Nairobi securities exchange. The study adopted an explanatory research design.The study was guided by research objectives.

5.2.1 Audit Committee Experience and Firm Performance

Hypothesis 1 stated that audit committee experience has no significant effect on firm performance. Nonetheless, research findings showed that audit committee experience has a significant effect on firm performance ($\beta_1 = 0.331$, $\rho<0.05$).Cognate to the results, Abbott et al. (2003) states that audit committee financial expertise is positively and significantly associated with firm performance. In the same way, Anderson et al. (2004) showed that an increase in audit committee experience leads to reduction in the cost of debt, in so doing the firm performance is improved. Also, Archambeault et al. (2008) echoes that the presence of audit committee financial expertise reduces the chances of fraud in a company thereby improving firm performance. This is because having experienced members on the board reduces the chances of misreporting and enhances effective monitoring (Raghunandan and Rama 2007).Moreover, markets react more positively to the appointment of a new AC member who is an expert (Davidson et al.2004; DeFond et al. 2005).This is due to the fact that experience leads to greater audit knowledge which in turn leads to quality monitoring and reporting hence improved firm performance.

5.2.2 Committee Gender Diversity and Firm Performance

Similarly, the findings are opposed to hypothesis 2 that holds that committee gender diversity has no effect on firm performance (β_2= 0.579, ρ<0.05).Thus, having gender diversity on the board will lead to a higher firm performance.In conformity with the findings, Bear et al., (2010) states that an increase in female directors on the board is positively associated with enhanced corporate reputation and therefore high firm performance. In a similar vein, Dennis and Kunkel (2004) are of the opinion that female audit committee members tend to be more competent, active/potent, emotionally stable, rational, independent, and less hostile than are male managers and as such they may be more sensitive for firm's false financial reporting. As well, Bernardi *et al*., (2006) asserts that corporations with high number of women on their board were more likely to on the 100 best companies to work for. Further support to the findings of the study is by Carter et *al.*, (2008) who states that gender diversity on the audit committee is positively associated with financial performance.

5.2.3 Number of Independent Auditors and Firm Performance

The findings provide evidence to suggest that the number of independent auditors negatively affects firm performance (β_3= -0.318, ρ<0.05).In line with the findings of the study, Abbott *et al.* (2000) shows that firms with independent directors on the board are less likely to be involved in financial misreporting hence establish positive investor perception and improved firm performance. Further, the presence of independent auditors reduces the chances of financial distress a company receives with the going concern opinion. In so doing, the independence of the audit committee is able to help the external auditor to maintain their fiduciary without influence from the directors (Carcello and Neal 1999).

5.2.4 Audit Committee Size and Firm Performance

The findings showed that audit committee size has a negative and significant effect on firm performance (β_4 = -0.213, ρ<0.05).Concurrently, Xie et al., (2003) found that the performance of the audit committee was determined by its size. In cases where the audit committee was large, it suffered from the problem of free riders and a higher probability of members to be more vulnerable to the pressures and more subject to follow other members' opinion without giving another argument. Further, Sharma et al. (2009) found out that the number of members on the audit committee can potentially have a positive impact on firm performance. Contrary to the results, Anderson et al, (2004) states that large size audit committees can protect and control the process of accounting and finance compared to small committees because of greater transparency with respect to shareholders and creditors leading to improved firm performance. From the foregoing prior studies, it is evident that the audit committee size has a mixed relationship with firm performance.

5.3 Conclusion

5.3.1 Audit Committee Experience and Firm Performance

The study shows that audit committee experience is positively associated with firm performance. The results of the study have shown that the presence of audit members with experience reduces the chances of financial misreporting which in turn improves firm performance. The chances of fraud are also reduced as well as the cost of debt. Further, vast wealth of experience of audit members is associated with quality monitoring and greater audit knowledge which is instrumental to improved firm performance.

5.3.2 Committee Gender Diversity and Firm Performance

Based on the study findings, committee gender diversity impacts positively on firm performance. The involvement of women in the board is advantageous to a firm since women are more competent, active/potent, emotionally stable and rational (Dennis and Kunkel 2004).Further, gender diversity promotes better understanding of the market since a wide array of skills are brought on board.

5.3.3 Number of Independent Auditors and Firm Performance

The results of the study have shown a negative and significant effect between the number of independent auditors and firm performance. It is generally believed that an increase in the number of independent directors leads to better financial monitoring and reporting which are of essence in improving firm performance. However, the negative association between the number of independent auditors and firm performance has shed new light onto the existing body of literature since prior studies have shown a positive association between the two variables (Abbott et al. 2000).

5.3.4 Audit Committee Size and Firm Performance

Finally, the findings of the study have also shown that the audit committee size is negatively associated with firm performance. With increased size of the audit committee, firm performance is expected to decline because of the problem of free riders and the pressure to follow other members' opinion without considering your argument. However, it can also be argued that large size audit committees can protect and control the process of accounting and finance since there is increased expert advice with increased size of the audit committee.

5.4 Recommendations

5.4.1 Audit Committee Experience and Firm Performance

The study has shown that audit committee experience is positively associated with firm performance. It is therefore utmost necessary for firms to re-elect audit committee members that have served for more than 9 years to the board because of their vast experience. Also, the presence of audit members with experience will also reduce financial misreporting and enhance quality monitoring. As such, having experienced audit committee members should be a key priority for firms.

5.4.2 Committee Gender Diversity and Firm Performance

There is evidence that committee gender diversity impacts positively on firm performance. Thus, there is need to include women in the board so as to increase firm performance. Also, when women are included in the board they will acquire the required expertise to manage the firm. Also an increase in the number of female members bring on board a wide array of experiences and talents. A lack of gender diversity can undermine productivity or lead to less creative thinking and creative problem solving.

5.4.3 Number of Independent Auditors and Firm Performance

The study has established that the number of independent auditors has a negative influence on firm performance. However, there is need to increase the proportion of independent auditors since an increase in their number reduces the chances of financial misreporting and leads to positive perception by investors. In so doing, there is improved firm performance. Moreover, in order to reduce financial distress in a company there is also need to increase the number of independent directors because they are independent and without influence from the directors.

5.4.4 Audit Committee Size and Firm Performance

Finally, there is need for firms to have an audit committee that is not too small such that there is lack of expert advice and too large such that it has free riders that are prone to follow other members opinion. The size of the audit committee should also be in a way that the process of accounting and finance are protected and firm performance is increased.

5.5 Limitations of the Study.

This study has looked at the effect of audit committee characteristics on firm financial performance among listed firms in Nairobi securities exchange.

This study included only four factors, there could be some other relevant factors that may be perceived important but were excluded from this study. Future researches, therefore, may consider more factors, like audit committee meetings, audit committee financial expertise and other variables such as audit committee composition that can influence firm's financial performance.

5.6 Recommendations for Further Research

This study recommends that another study be done to augment finding in this study; it therefore recommends a study be done on more number of firms rather than including only firms in the NSE for the sake of generalizing the results of the study. Moreover, including moderator factors can also be made in the research models of the new research by other scholars in future.

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APPENDIX I: DOCUMENT ANALYSIS GUIDE

This documentary analysis guide was be used to guide the researcher while analyzing companies document and from the companies themselves.

YEAR	No. of members in audit committee	Number of independent members	Audit committee gender diversity	Audit committee experience years	Return on Assets
AGRICULTURAL					
Eaagads Ltd					
Kapchorua Tea Co. Ltd					
Kakuzi Ltd					
Limuru Tea Co. Ltd					
Rea Vipingo Plantations Ltd					
Sasini Ltd					
Williamson Tea Kenya Ltd					
COMMERCIAL AND SERVICES					
Express Ltd					
Kenya Airways Ltd					
Nation Media Group Ord.					
Standard Group Ltd					
TPS Eastern Africa (Serena) Ltd					
Scangroup Ltd					
Uchumi Supermarket Ltd					
Hutchings Biemer Ltd					
Longhorn Kenya Ltd					
TELECOMMUNICATION AND TECHNOLOGY					
Safaricom Ltd					
AUTOMOBILES AND ACCESSORIES					
Car and General (K) Ltd					
CMC Holdings Ltd					
Sameer Africa Ltd					
Marshalls (E.A.) Ltd					
BANKING					
Barclays Bank Ltd					
CFC Stanbic Holdings Ltd					
I&M Holdings Ltd					
Diamond Trust Bank Kenya Ltd					
Housing Finance Co Ltd					
Kenya Commercial Bank Ltd					
National Bank of Kenya Ltd					
NIC Bank Ltd 0rd					
Standard Chartered Bank Ltd					
Equity Bank Ltd					
The Co-operative Bank of Kenya Ltd					

INSURANCE					
Jubilee Holdings Ltd					
Pan Africa Insurance Holdings Ltd					
Kenya Re-Insurance Corporation Ltd					
Liberty Kenya Holdings Ltd					
British-American Investments Company (Kenya) Ltd					
CIC Insurance Group Ltd					
INVESTMENT					
Olympia Capital Holdings ltd					
Centum Investment Co Ltd					
Trans-Century Ltd					
MANUFACTURING AND ALLIED					
B.O.C Kenya Ltd					
British American Tobacco Kenya Ltd					
Carbacid Investments Ltd					
East African Breweries Ltd					
Mumias Sugar Co. Ltd					
Unga Group Ltd					
Eveready East Africa Ltd					
Kenya Orchards Ltd					
A. Baumann CO Ltd					
CONSTRUCTION AND ALLIED					
Athi River Mining					
Bamburi Cement Ltd					
Crown Berger Ltd					
E. A. Cables Ltd					
E. A. Portland Cement Ltd					
ENERGY AND PETROLEUM					
Kenol Kobil Ltd Ord					
Total Kenya Ltd					
Ken Gen Ltd Ord					
Kenya Power & Lighting Co Ltd					
Umeme Ltd					

Source: Nairobi Stock Exchange Hard Book (2013).