

**DETERMINANTS OF AUDITOR CHANGE AMONG COMPANIES LISTED ON
NAIROBI SECURITIES EXCHANGE**

BY

KENNETH CHEBOI AMDANY



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DECLARATION

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

Signed.....*Kenneth*..... Date.....*12-11-2012*.....

KENNETH CHEBOI AMDANY

D61/75448/2009

This project has been submitted with my approval as the University Supervisor.

Signed.....*J. Barasa*..... Date.....*12/11/12*.....

MR. BARASA JOSEPH LUMUMBA

DEPARTMENT OF FINANCE & ACCOUNTING

SCHOOL OF BUSINESS

UNIVERSITY OF NAIROBI

DEDICATION

This work is dedicated to investors, both current and future, in the Nairobi Securities Exchange.

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Glory to God, the Creator of Heaven and Earth. I thank Him for taking me this far and for the wisdom and courage to successfully complete this work. I would also like to acknowledge the following for their contributions, which facilitated the completion of this project.

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ABSTRACT

Clients may incur both direct and indirect costs when they decide to change auditors, so questions arise in the reasons behind auditor change when there are direct and indirect costs with it. Different factors may have an impact on auditor change. Thus, the aim of this study was to determine the factors that influence auditor changes by companies listed on Nairobi Securities Exchange.

This study was designed as a correlation design. The population was 60 listed firms at the Nairobi Securities Exchange. Primary data was collected using questionnaires administered through drop and pick method. Analysis was carried out using descriptive analysis and conditional logit regression analysis.

The study found that the determinants of auditor switch were auditor's lack of industry expertise, management change, change of auditor at the head office, and demand by the shareholders. The factors that significantly informed firms not to switch auditors were affordable fees, satisfactory quality of audit, shareholders demand, auditor's good reputation, accessibility of auditor, timeliness of audit report, lack of reporting disputes, demand by the head office, and unsurpassed industry expertise. The study concludes that other than the mandatory rotation requirement for listed firms, client firm-specific factors, audit firm specific factors, and key stakeholder factors influence decision to retain or to change the auditor.

These findings have important implications for audit firms operating in Kenya. First, audit firms should ensure that their expertise as regards advisory and audit to various

industries is impeccable if they are to be retained by their clients. Audit firms also need to charge fees that are affordable to firms as this is a major determinant of their retention. Further, audit firms should endeavor to do quality audits, maintain good reputation, be accessible to clients for any consultations, and present audit reports in time.

TABLE OF CONTENTS

DECLARATION.....	i
DEDICATION.....	i
ACKNOWLEDGEMENTS	ii
ABSTRACT	iii
LIST OF TABLES	vii
LIST OF FIGURES	viii
LIST OF ABBREVIATION.....	ix
CHAPTER ONE	1
INTRODUCTION.....	1
1.1 Background of the Study.....	1
1.2 Statement of the problem	9
1.3 Objectives of the Study	10
1.4 Value of the Study.....	10
CHAPTER TWO	12
LITERATURE REVIEW	12
2.1 Introduction	12
2.2 Theoretical Review	12
2.3 Empirical Review.....	14
2.4 Conclusion.....	23
CHAPTER THREE	24
RESEARCH METHODOLOGY	24
3.1 Introduction	24
3.2 Research Design.....	24
3.3 Population and Sample.....	24
3.4 Data Collection.....	24
3.5 Data Analysis	26
3.6 Data Validity and Reliability.....	27

CHAPTER FOUR.....	28
DATA ANALYSIS, RESULTS AND INTERPRETATION.....	28
4.1 Introduction	28
4.2 Sample Characteristics	28
4.3 Factors Influencing Auditor Change	34
4.4 Discussion of Findings	38
CHAPTER FIVE	40
SUMMARY, CONCLUSION AND RECOMMENDATIONS	40
5.1 Introduction	40
5.2 Summary of Study Findings.....	40
5.3 Conclusion.....	41
5.4 Recommendations for Policy	42
5.5 Limitations of the Study	42
5.6 Suggestions for Further Research	43
REFERENCES.....	44
APPENDIX.....	49
Appendix A: Listed companies in the Nairobi Securities Exchange.....	49
Appendix B: Introductory Letter.....	51
Appendix C: SURVEY QUESTIONNAIRE	52
Appendix D: Summary of Past Research Studies	56

LIST OF TABLES

Table 3.1: Operationalization of Variables.....	25
Table 4.1: Factors influencing auditor change.....	35
Table 4.2: Factors influencing no auditor change.....	36
Table 4.3: Determinants of Auditor Switch.....	37

LIST OF FIGURES

Figure 4.1:	Company ownership	28
Figure 4.2:	Proportion of ownership in joint ventures	29
Figure 4.3:	Whether management is allowed to own interest	29
Figure 4.4:	Whether employees are allowed to own interest in the company.....	30
Figure 4.5:	Status of the companies	30
Figure 4.6:	Number of branches in Kenya	31
Figure 4.7:	Age of companies	31
Figure 4.8:	Number of audit firms seeking engagements with the companies	32
Figure 4.9:	Number of employees in the companies	32
Figure 4.10:	Whether companies changed auditors between 2002 and 2011.....	33
Figure 4.11:	Period when auditors were changed.....	33

LIST OF ABBREVIATION

AC	Auditor Change
AGM	Annual General Meeting
CEO	Chief Executive Officer
IDX	Indonesia Stock Exchange
NSE	Nairobi Securities Exchange
PWC	PricewaterhouseCoopers
TSE	Tehran Stock Exchange
UK	United Kingdom

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Financial reporting provides the required information to managers, investors, creditors and government. This financial reporting is done by providing financial statements like statement of financial position, statement of income, statement of cash flows (Chadegani, Mohamed and Jari, 2011). The users of financial statements can rely on this information only when someone who is independent confirms its reliability. Firms can employ reputable auditors to assure outside investors of the credibility and reliability of financial disclosures and hence mitigate the agency problems (Anderson, Kadous & Koonce, 2004).

Auditing is defined as a systematic process of objectively obtaining and evaluating evidence regarding assertions about economic actions and events to ascertain the degree of correspondence between those assertions and established criteria and communicating the results to interested users (Kanter, 1990). An auditor on the other hand, is a professional accountant who is hired by a company to perform an audit and render an opinion on the statements to be produced for a third party (Nicholas and price, 1976)

At present auditing literature covers a wide array which includes: external auditing, internal auditing, operational auditing, management auditing, comprehensive auditing, forensic auditing and public sector auditing including not for profit organizations (Puttick and Van Esch, 2003).

Collis, Jarvis, and Skerratt (2004) define external audit as those audits conducted under the provisions of the law of a country while Nzomo (2002) suggests that external audit arises under the statute, a result of which it becomes a statutory obligation for the accounts of some organizations to be audited annually by a professionally qualified auditor.

The reasons why the external audit services are conducted are many. "The external audit profession performs a unique task. It does not create the financial statements neither does it design the internal control systems for a public audit client, it must function as an independent examiner to determine if the financial statements are fairly stated and if the internal controls of the organization are effective" (Rittenberg, Schwieger and Johnstone, 2008).

Auditor change decision involves change of incumbent auditor resulting in the choice of quality differentiated audit firms to realign the characteristics of the audit firm, with the growing need of clients under changing circumstances (Huson Joher, Shamsheer & Annuar, 2000).

Auditor change is the end result of a bargaining process which begins with a client requesting an auditor for an audit service. The client invites the auditor to make a proposal to audit an engagement. The auditor seeks permission to communicate with his/her predecessor. The auditor bargains for the terms of the audit engagement together with the scope of the services. This bargaining process represents a power struggle

between management and the auditor. Management is often seen as having a broader power base than the auditor (Knapp, 1985).

Decision to change auditors by client firm was due to the principle-agent problem in separation of ownership and control of a firm (Jensen & Meckling, 1972) and the separation of risk bearing, decision-making and control function in firms (Fama & Jensen, 1988).

Auditor independence is the cornerstone of the auditing profession. In general, auditor independence can be of two forms: "independence in fact" and "independence in appearance". The former requires auditors to form and express an opinion in the audit report as a disinterested and expert observer, uninfluenced by personal bias, while the latter expects auditors to avoid situations that might cause others to conclude that they are not maintaining an unbiased objective attitude of mind (Porter et al., 2003).

Flint (1988) argued that independence will be lost if the auditor is involved in a personal relationship with the client, as this may influence their mental attitude and opinion. One of such threats is lengthy tenure. He contends that lengthy tenure in office may cause the auditors to develop "over-cosy relationships" as well as strong loyalty or emotional relationships with their clients, which could reach a stage where auditor independence is threatened. Lengthy tenure also results in "over familiarity" and consequently, the quality and competence of auditors' work may decline when they start to make unjustified assumptions instead of objective evaluation of current evidence.

Hence, to maintain public confidence in the audit function and to protect auditors' objectivity, the profession through a series of clauses proscribes auditors from having personal relationships with their clients that may give rise to a potential conflict of interests. One of the proposals is to have mandatory auditor rotation as it may increase auditors' ability in protecting the public via the increase in alertness to any possible improprieties, increase in quality service and prevent closer relationship with client (Brody and Moscovice, 1998).

1.1.1 Determinants of Auditor change

The nature of factors that trigger auditor changes could be behavioural, economic or perhaps a mixture of the two. Literature tends to find mixed evidence of the importance of each category of factors within the auditor-change process. Beattie and Fearnley (1998) allege that while behavioural factors are dominant when it comes to selecting an auditor, purely economic factors are the more significant drivers of change.

Prior researches have shown that companies change auditors due to factors such as change in management, auditor size, qualified audit opinion, change in audit fee and others (Ismail & Aliahmed, 2008). The study categorized these factors in two groups: 1) client factors and 2) auditor factors. They considered change in management, financial distress and client's size as factors that related to the firm and qualified audit opinion, audit quality and change in auditor fees as factors that related to auditor.

Various authors contend that one economic factor, the audit fee, is the most frequently cited reason for changing auditors, supporting the concern that exists regarding price-

cutting in the auditing profession (Bedingfield and Loeb, 1974; Woo and Koh, 2001). Fees precipitate change more often when they exceed "acceptable tolerance limits". Otherwise companies find that it is not worth going through a costly auditor change process as a reaction to a slight fee increase.

Prior research found that clients receiving an unclean audit report were likely to change auditors (Chow and Rice, 1982; Vanstraelen, 2003), perhaps because the management or the controlling shareholders believed that once an incumbent auditor was dismissed, the firm could find a more pliable auditor whose opinion would be more in line with the management's views. On the contrary, others report a negative association (Woo and Koh, 2001) or no association (Schwartz and Menon, 1985; Haskins and Williams, 1990).

A major candidate of auditor changes is audit quality, which concerns the ability of the auditor to detect problems and breaches in the accounting system. Menon and Williams (1991) contend that quality serves as an important differentiating audit attribute and is heavily reliant on the perceived credibility that certain auditors bring to their engagements, based on their reputation. Audit quality incorporates components such as the size of the audit firm in question, its brand name, independence practices and level of expertise. When company management has its incentives closely aligned with those of the owners, there is reduced need for the attributes which differentiate one audit firm from another in terms of quality. This is so because agency costs are minimal and no extra effort needs to be taken in making management credible to potential investors.

On the contrary, there are positive relationships between increased agency costs and auditor change, with Auditor-change decisions company owners always seeking the services of "better quality" auditors such that the monitoring of management's stewardship would be more effective (DeFond, 1992). Indeed, auditor changes occur more frequently by companies employing non-Big 4 audit firms. Having more resources to provide a certain level of service, the larger audit firms are synonymous with better quality (Woo and Koh, 2001).

Disagreements over accounting principles could effectively trigger auditor changes. Income-decreasing accounting choices targeted towards minimising litigation risk by the auditor often characterise the last year with a predecessor auditor, while such discretionary accruals lose importance immediately in the first year of appointment of the new auditor (DeFond and Subramanyam, 1998). However, according to Whisenant and Sankaraguruswamy (2000), accounting disagreements account for only a minimal percentage of client-initiated auditor changes. This view supports earlier evidence by Beattie and Fearnley (1998).

The financial position of client has important implications on decisions in retaining the audit firm. Clients who are insolvent and experiencing unhealthy financial position are more likely to engage auditors having high independence to boost the confidence of shareholders and creditors as well as to reduce the risk of litigation (Francis and Wilson, 1988). In addition, financially stressed clients are more likely to replace their audit firms compared to their healthier counterparts due to the reason that these types of companies

need to hire a higher quality of auditor compared to the previous one (Schwartz and Menon, 1985; Hudaib and Cooke, 2005).

It has been argued that larger clients, due to the complexity of their operations and the increased gap in the separation between management and ownership, demand highly independent audit firms to reduce agency costs (Watts and Zimmerman, 1986) and auditors' self-interest threat (Hudaib and Cooke, 2005). Furthermore, as the size of the companies increases, it is likely that the number of agency conflicts also increases and this might increase the demand for quality-differentiated auditors (Palmrose, 1984).

According to past studies, management influences auditor choice decision and have a motivation of changing auditor in order to pursue their own self interests (Williams, 1988). With changes in corporate managers and directors, new managers may prefer to change auditors because they have a preferred working relationship with a particular auditor (Williams, 1988) they have a personal relationship with a particular auditor (Beattie and Fearnley, 1998) or they seek an auditor who is more accommodating with respect to their choice and application of accounting policies (Schwartz and Menon, 1985). It is argued that change in management should be positively related to auditor change.

Management of subsidiaries may be prevailed upon by the head office to change their local auditors to correspond with changes made by the headquarters (Kemei, 1992). Some

of the public companies in Kenya are subsidiaries whose parent companies influence their decisions including those on auditor changes.

Prior studies (Francis and Wilson, 1988, Woo and Koh, 2001) indicate that highly concentrated ownership is negatively associated with changing to a higher quality auditor. When ownership is highly concentrated, the large shareholders are more able to monitor management (Shleifer and Vishny, 1997) and management discretion over accounting policy is more constrained (Piot, 2001). This suggests that large shareholders are less likely to demand a higher level of audit quality.

In this study, it is therefore expected that auditor change will be significantly influenced by change in management, industry expertise, reporting dispute, auditor size, change in audit fee, qualified audit opinion, financial distress, audit quality, reputation, demand of shareholders, and influence by head office.

1.1.2 Overview of the Nairobi Securities Exchange

The Nairobi Securities Exchange (NSE) re-classified the listed companies in 2011 into 12 sectors to align them with various sectors of the economy. These sectors are agricultural (7 companies), commercial and services (9 companies), telecommunication and technology (2 companies), automobiles and accessories (4 companies), banking (10 companies), insurance (6 companies), investment (4 companies), manufacturing and allied (9 companies), construction and allied (5 companies), and energy and petroleum (4 companies). The other two sectors are fixed income securities market segment which lists

preference shares and bonds. In total, there are 60 companies currently listed and trading on the NSE.

1.2 Statement of the problem

Clients may incur both direct and indirect costs when they decide to change auditors, so questions arise in the reasons behind auditor change when there are direct and indirect costs with it. Different factors may have an impact on auditor change such as disagreement about content of financial reports (Addams and Davis, 1994), disagreement about auditor opinion (Haskins and Williams, 1990), change of management (Beattie and Fearnley, 1998) and auditor fees (Addams and Davis, 1994). These factors may cause auditor change and they may reduce the auditor's independence as well. Thus, the aim of this study is to determine the factors that influence auditor changes by companies listed on Nairobi Securities Exchange.

There are a total of 60 companies currently listed on the Nairobi Securities Exchange in 12 sectors. Most of these companies are audited by the Big Four audit firms (PwC, Deloitte, KPMG, and Ernst & Young). The rest of the other audit firms audit a very small number of listed firms. The companies change auditors mostly on a rotational basis but some change auditors for other reasons other than the rotation hence the need for a study to find out what other factors determine such change in Kenya.

To our knowledge, no study has previously examined auditor changes in the companies listed on Nairobi Securities Exchange. The study done by Kemei (1992) focuses on unquoted

companies in Nairobi. However, there are a number of studies that have been done on auditors in Kenya. For instance, Mutiga (2006) studied the role of external auditors in corporate governance, Kibara (2007) studied internal auditors risk management practices in the banking industry, while Murithi (2009) studied the role internal auditors in enterprise wide risk management for listed companies in Kenya.

Auditor change has received a lot of attention elsewhere. (Chow and Rice, 1982; Roberts et al, 1990; Beattie, Goodacre and Masocha, 2006; Lin and Liu, 2010; Chadegani, Mohamed and Jari, 2011; Sulfiyah, 2011 among many other scholars. The table in appendix D summarizes the results of these studies.

Given the growing demand for accountability, the crucial role of external audit, auditor independence and the seemingly lack of interest by scholars in Kenya on this area, the objective of the study is to begin to fill this void in our knowledge.

1.3 Objectives of the Study

The objective of this study is to determine the factors that influence auditor change by companies listed on Nairobi Securities Exchange.

1.4 Value of the Study

The research will be useful to a number of stakeholders. First, the companies will understand the reasons why they should switch auditors on a regular basis and also get to know the signs that call for auditor switching.

The study will also be invaluable to the audit firms in Kenya as it will show what factors their clients consider in auditor switching. This will greatly assist them in making decisions on client sourcing and retention.

The study will also be very useful to ICPAK in promulgating audit guidelines. Lastly, Researchers and academicians in the field of accounting and auditing will find this study a useful guide for carrying out further studies in the area.



CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter presents the literature review. First, a theoretical review is provided focusing on theories that explain auditor change. Secondly, the empirical review of the studies that have been done on the determinants of auditor change is made. The summary of chapter as well as the conclusion is provided.

2.2 Theoretical Review

2.2.1 Agency Theory

In contemporary market economies, business incorporation led to the separation of ownership and management. Firms' owners (shareholders) would not directly involve in business administration and professional managers are hired to run daily business operations. Due to varied self-interests and information asymmetry, business managers may pursue their self-welfare even at the expense of the owners and other stakeholders, which result in agency costs that must be eventually borne by the management (Jensen and Meckling 1976). Thus a series of mechanisms or measures are imposed to bind the managers and to induce them to act in the best interest of the owners. One of the binding mechanisms is the auditing function performed by independent professionals over the operations and information disclosures provided by the management (Watts and Zimmerman 1986; Willenborg 1999).

Auditing can reduce agency risks created by conflict of interests between managers and shareholders (Watts and Zimmerman, 1983); small and large shareholders (Fan and Wong, 2005); and shareholders and debt holders (Watts and Zimmerman, 1986). These agency costs arise due to a contractual relationship between the auditor and the client. The client (Principal) hires an auditor to control the stewards of the client's interests in the organization and to improve the risk sharing arrangement by management and owners of the company.

2.2.2 Signalling Theory

Most of the past academic research focused on signalling theory or the information role of auditor choice to explain why a client changes auditors. Signalling theory states that clients change auditors when they want to convey or signal to the public the quality or reliability of their financial statements and they do this through the type of auditor they engage (Bagherpour, Monroe and Greg, 2010). Both analytical and archival studies (Willenborg, 1999) support the information or signalling role of auditor choice. A client may experience a negative stock price reaction if the market views the termination as a signal of poor economic prospects (Dhaliwal et al. 1993). In information economics, the selection of credible auditors is used to signal management's honesty (Dopuch and Simunic, 1982).

The value of the audit service to users of audited financial statements depends on the perceived usefulness of the information contained in the financial statements. In a market characterised by the existence of information asymmetry, an informed party may change an auditor to facilitate the release of its private information to uninformed party.

Researchers have indicated that shareholders endeavour to induce management to disclose information to market participants by signalling through the act of selecting an auditor.

The privatization policy and the rapid increase in competition in the audit, managerial labour and capital markets has increased agency costs and signalling incentives for Kenyan listed companies, which can be linked to incentives for auditor change. In an emerging securities market such as the NSE, the role of auditors as a means of reducing conflicts of interest in financial reporting decisions is potentially more important than in the case of developed markets. Consequently, investigating the factors that affect auditor change, which can impair auditor independence and ultimately audit quality, becomes very important.

2.3 Empirical Review

Several studies have been undertaken in auditing to address the issue of auditor changes. Inspired by a desire to increase our understanding of auditor changes, several studies have relied on surveys (Branson and Breesch 2004), a scrutiny of disclosed reasons for changing auditors (Grothe and Weirich 2007) and/or empirical research (Woo and Koh 2001) in an attempt to bare the underlying reasons for auditor changes. As argued by Woo and Koh (2001), a greater understanding of the major determinants of auditor changes can enhance the credibility of the audit function (i.e., auditor changes are often associated with a poor financial condition).

Chow and Rice (1982) studied the influence of qualified audit opinions on auditor changes. Data for the study was obtained for 9,460 companies that had qualified opinions in 1973 and changed auditors between the 1973 and 1974 fiscal year-ends. The results of the study supported the contention that firms change auditors more frequently after receiving qualified audit opinions. In addition, they investigated the influence of other factors on auditor changes such as management change, merger activity, new financing, and an accounting dispute with an auditor. The conditional logit model was formulated for analyzing the effect of the variables on auditor changes. Using the conditional logit model, qualification was found to be the only significant variable in explaining auditor changes.

Schwartz and Menon (1985) undertook an investigation into the motivations for failing firms to change auditors. In addition to financial distress, they included other factors cited in prior studies. The other factors included in their study were changes in corporate management, the need for additional audits services, disagreement over reporting matters, and conflict over audit fees. Their study used a sample of 132 firms that had filed a bankruptcy petition during the years 1974 to 1982. The chi-square test of independence was employed to determine whether the tendency of failing firms to change auditors is different from that of non-failing firms. It was found out that the timing of the auditor changes made by failing firms revealed that the closer a company gets to bankruptcy, the more likely it was to change its auditor. They did not find audit qualification as a significant factor influencing auditor changes. In addition, they did not find evidence, to show that management change was related to auditor changes. According to their study,

size did not appear to matter with respect to the observed auditor change among the failing firms.

Francis and Wilson (1988) in their study, sought to test whether there is a positive association between a firm's agency costs and its demand for a quality differentiated audit. A sample of 196 firms that changed auditors during the period between June 1978 and April 1985 was selected for the study. The framework adopted in the study was aimed at finding whether or not there is an association between auditor changes and the firm's agency costs. The study constituted a joint test of audit quality differentiation and the demand for higher quality audits as a function of agency costs. The results of the study showed that neither client size nor agency costs could explain a large portion of the demand for larger size auditors. Agency costs were found to affect only marginally auditor choice.

Roberts et al (1990) carried out a study to investigate the determinants of auditor change in public sector using data from public school districts in Texas. The study examined the effect of audit fees, internal control weaknesses, change of superintendent in the preceding years, and school board noncompliance with reporting standards. The study employed a stepwise logistic regression model to test the relation between auditor change and the explanatory variables. The results indicated that audit fees, reports of material internal control weaknesses, and the school boards noncompliance with laws and regulations governing financial reporting were significantly related to auditor change in public sector.

Ettredge and Greenberg (1990) studied the determinants of fee cutting on initial audit engagements. A sample of 389 firms that reported to auditor change during the period 1984 and 1987 was examined. The factors that were investigated in this study included client financial health, auditor class, industry expertise, number of bidding auditors and technological efficiency. A regression model was used to test relation between audit fee and the factors aforementioned. The results of the study supported the importance of auditor class, industry expertise, technological efficiency, and number of auditor bidders in determining the percentage fee cuts.

Johnson and Lys (1990) obtained evidence of voluntary auditor changes by 698 companies in their study of the market for audit services. They concluded that voluntary auditor changes are caused by market forces. They identified the market forces as: 1) Specialization that enables audit firms to obtain competitive advantage, 2) Clients tendency to purchase audit services from the least costly suppliers in the market. 3) The changes in clients' operations and activities that erode the competitive advantage of an incumbent auditor. The study covered voluntary auditor changes that occurred through 1982. They concluded that the changes could be explained as an efficient response to the sting of competition among audit firms.

A study by Dye (1991) addressed the firm's decision to replace its auditor(s) when the replacement affects outsiders' perception of its financial condition and auditor's attestation. He asserts that an auditor is never replaced if the auditor and the firm possess common information about the firm's financial status, and this information can be

communicated through financial statements to outsiders. According to him, the auditor is replaced if the firm possesses information superior to that of the auditor and financial reports reflect only the auditor's information. The action taken by the firm to replace the auditor is dictated by the outsiders' intelligent interpretation of the client's financial statements.

Kemei (1992) carried out a study to investigate the determinants of auditor changes by unquoted companies operating in Nairobi. A sample of 100 firms out of 25,463 companies was selected, covering the period 1981 – 1990. Primary data was collected using a questionnaire. The study examined fifteen factors obtained from pertinent literature on auditor change. They included audit fees, quality of audit service, industry expertise, management change, reporting disputes, qualified opinion, auditor reputation, lacked confidentiality, influence of head office, need for non audit services, size, organization complexity, demand by shareholders and tax services. The conditional logit model and correlation analysis were used. The results showed that quality of audit service was very significant whereas organization complexity, size and financial distress were significant in explaining auditor changes. However, most of the identified factors, did not show any significant influence of auditor change.

Magri, and Baldacchino (2004) examined perceptions of behavioural, economic or other factors that influence auditor-client realignments in Malta using a mail questionnaire responded to by 97 Maltese companies. The findings were complemented by 15 interviews with companies that actually changed their auditor. The study concludes

primarily that behavioural forces provide the principal motivators of auditor changes in Malta. Deterioration in the working relationship with the auditor and lack of accessibility feature as foremost concerns. Economic forces, albeit being important triggers of auditor changes, come only secondary in importance. Underlying this, there is evidence of differences in the attitudes of clients and non-clients of Big 4 audit firms as well as between small and large companies.

Chan, Lin and Mo (2006) examined whether auditor opinions are affected by political and economic influences from governments. The study used auditor locality (local versus non-local) to capture such influences from local governments in China. Based on data from China's stock markets for the period 1996–2002, they found that local auditors, who have greater economic dependence on local clients and are subject to more political influence from local governments than non-local auditors, are inclined to report favourably on local government owned companies to mitigate probable economic losses. Moreover, companies with qualified opinions are more likely to change from a non-local auditor to a local auditor than companies with unqualified opinions. Contrary to some prior studies, they found that in China's political environment, local government-owned companies that changed from a non-local auditor to a local auditor after receiving a qualified opinion can succeed in opinion shopping.

Beattie, Goodacre and Masocha (2006) carried out a study to investigate the determinants of auditor changes in the voluntary sector using data from charities in the United Kingdom. The study examined the effect of management change, change in financing,

charity reputation, auditor quality and audit fees. Based on a large dataset of 276 UK charities (138 that changed auditor between 1999 and 2003 and a matched set of charities), they developed a logit regression model of the determinants of auditor change. The results showed that charities were more likely to change auditor if the incumbent auditor was 'top tier', if the new auditor had greater expertise in the charity sector, if the charity had an audit committee and if the charity income had fallen significantly. In contrast with the private sector, the desire to reduce the audit fee was not a determinant of change.

Landsman, Nelson and Rountree (2009) using a comprehensive sample of lateral changes among the largest auditors in their study documented that the probability of a lateral change in Big N audit firms increases significantly in both the audit and financial risk of the client in the pre-Enron period but not in the post-Enron period. In both periods, clients changing downward to a non-Big N auditor pose similar audit and financial risks as lateral Big N changes, but are smaller and tend to have going concern opinions. They interpreted their findings as evidence that the swapping of large, risky clients between Big N auditors is less prevalent in the post-Enron era, suggesting that Big N auditors may have become more sensitive to risky clients in recent years.

Lin and Liu (2010) carried out a study to investigate the determinants of auditor change from the Perspective of corporate governance in China. The study investigated the association between firms' internal corporate governance mechanism and their auditor change decisions. They identified two types of auditor change, namely changing to a

larger auditor and changing to a smaller auditor. Three variables were used to proxy for firms' internal corporate governance mechanism, including the ownership concentration (shareholding by the largest owner), the effectiveness of Supervisory Board (SB), and the duality of chairman of Board of Directors (BoD) and CEO. Logistic regression model was used in the study. The study findings indicated that firms with weak internal corporate governance mechanism tend to change to smaller or more pliable auditors in order to sustain the opaqueness gains derived from weak corporate governance. On the other hand, they found that with improvement of corporate government, firms should be more likely to choose large (high-quality) auditors in making auditor change decisions.

Lopez and Peters (2011) investigated the impact of the busy season and concomitant concentrated demands on audit resources on the likelihood of auditor change. They employed a sample of 10,238 company-year observations for years 2004 through 2007 and found evidence consistent with December year-end companies having a lower likelihood of auditor change than that of non-December year-end companies. However, they also found evidence of a significantly positive association between the likelihood of auditor change and workload compression. Thus, their results suggest that it is not just the fiscal year-end month of a client that matters, but the concentration of busy season companies within an auditor's client portfolio also affects the auditor-client relationship.

Chadegani, Mohamed and Jari (2011) carried out a study to investigate the determinant factors of auditor change among companies listed on Tehran Stock Exchange (TSE). The association between factors related to client and auditor characteristics and auditor

changes were analyzed. 6 factors were analyzed namely, audit fees, auditor opinion, audit quality, client size, changing management and financial distress. A sample of 182 companies that listed on TSE (91 companies had auditor change during 2003-2007 and 91 companies without change) was selected. Logistic regression model was used in the study. Results indicated that between 6 factors that were analyzed, only auditor size was significantly related to auditor change among companies listed on Tehran Stock Exchange. Furthermore, consistent with previous studies, the study showed that there was no significant relationship between receiving qualified audit opinion and auditor change.

Sulfiyah (2011) carried out a study aimed at determining the factors affecting companies in Indonesia to auditor change. The variables used in the study were change management, firm size, firm growth, financial distress, previous audit opinion and audit fees. The data used was financial statement data of service sector companies listed in the Indonesia Stock Exchange (IDX) from year 2005 to 2010. The hypothesis was tested using regression analysis. The results indicated that the variables that significantly influence auditor change are a change of management, previous audit opinion and audit fees. The other variables in the study such as firm size, growth and financial distress were not seen to affect auditor change.

Luybaert and Van Caneghem (2012) explored the drivers of auditor change by the acquired firm after a takeover among a sample of Belgian takeovers. They employed binary probit regression analysis and related different types of variables borrowed from the auditing literature (e.g., similarity of activities between the acquired and the acquiring

firm, auditor size, type of audit opinion, agency variables) to the auditor change decision. Their results confirmed prior evidence indicating that the majority of acquired firms change to the auditor of the acquiring firm after the takeover. Whereas prior results are inconclusive, their results suggest that similarity of activities between the acquired and the acquiring firm does not affect the decision to replace the acquired firm's auditor. However, the results indicate that the likelihood of an auditor change is significantly higher when the acquiring firm is listed. Agency variables (at both the acquired and the acquiring firm level) are also found to affect the auditor change decision.

2.4 Conclusion

The empirical review above has shown the determinants of auditor change by firms. But these studies were done in different environments and hence the results may not be generalized to developing countries such as Kenya. There is therefore a gap in literature as regards the determinant factors of auditor change among companies listed on Nairobi Securities Exchange. This is a gap the present study sought to bridge.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter presents the research methodology. First, a presentation of the research design is provided. This is followed by an explanation on the target population, description of research instruments, description of sample and sampling procedures, description of data collection procedures and a description of data analysis procedures.

3.2 Research Design

The study used a correlation design. This is because this method most captures the objectives of the study. In this manner, the study was able to establish the relationship between the variables in the study. This was therefore the appropriate research design in this study.

3.3 Population and Sample

The population of this study comprised all the 60 listed companies in the Nairobi Securities Exchange. (See appendix A). This was a census study, given that the number is not so large.

3.4 Data Collection

In this study primary data was used to investigate the relationship between independent and dependent variables. The dependent variable was auditor change and the independent

variables included change in management, auditor size, qualified audit opinion, client size, change in auditor fees and financial distress, among other variables. These were measured using the proxies in Table 3.1.

Table 3.1: Operationalization of Variables

Symbol	Variable	Proxies
α	Value of Intercept	
Y	Auditor change	Dummy value of 1 if firm changes auditor and 0 otherwise
X ₁	Change in management	Dummy value of 1 if management change took place and 0 otherwise
X ₂	Industry expertise	Auditor lacked industry expertise, takes 1, 0, or otherwise
X ₃	Reporting dispute	If reporting dispute occurred 1, otherwise 0
X ₄	Auditor size	Takes a value of 1 if the auditor is one of the big 4 and 0 otherwise.
X ₅	Change in audit fee	Takes a value of 1 if audit fee unaffordable and 0 otherwise.
X ₆	Qualified audit opinion	Takes a value of 1 if firm received qualified audit opinion and 0 otherwise.
X ₈	Audit quality	Unsatisfactory quality of audit service, takes 1, 0, otherwise
X ₉	Reputation	Poor reputation of auditor, takes 1, 0, otherwise
X ₁₀	Influence by head office	Takes a value of 1 if influenced by head office and 0 otherwise
X ₁₁	Demand by shareholders	Takes a value of 1 if demanded by shareholders and 0 otherwise
X ₁₂	Other	Takes a value of 1 if other reason and 0 otherwise
ϵ	Error Term	

A questionnaire was designed and used to collect the primary data on the variables of interest in the study. (See appendix C). The questionnaires were administered using drop

and pick later method, so as to encourage response. A 10 year period from 2002 to 2011 was selected for analysis. In order to create the X variables in Table 1 above, the responses on the factors (X variables) were translated into dummy variables. A response of 3 or 4 meant that the factor was significant and therefore scored a dummy variable of 1 while a response of 1 or 2 on the questionnaire was translated to a dummy variable of 0 in the model. These dummy variables were then regressed with the Y (auditor change).

3.5 Data Analysis

The data was analysed using both descriptive statistics and conditional logit regression model. The descriptive statistics were the frequencies, percentages, mean, and standard deviation. The following model was therefore used in the study.

$$Y_i = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \beta_5 X_5 + \beta_6 X_6 + \beta_7 X_7 + \beta_8 X_8 + \beta_9 X_9 + \beta_{10} X_{10} + \beta_{11} X_{11} + \beta_{12} X_{12} + \epsilon$$

Strength of the model was tested using significance of T statistic at 5% level. Conditional logit model is a statistical tool for analysing data for which the response variable is dichotomous in nature. The dependent variable in this study is auditor change, a qualitative variable symbolized by AC. The model is advantageous in that it yields estimators that are asymptotically efficient and normally distributed. In addition, it is a reasonably good approximation procedure even for quite small samples. This is indeed useful and will take care of the inherent risk of non-response.

3.6 Data Validity and Reliability

There are two types of validity: content and criterion. Content validity has been taken care of because the measures used here represent all the facets of determinants of auditor change. None of the measures has been left out. The measures used in this study are relevant since they have been used by other scholars in similar studies. There is also freedom from bias since all the variables have an equal chance in the dataset.

Reliability is enhanced by the fact that the data can be used to reproduce the same results elsewhere. To ensure reliability of the scales used, the split-half method was used to calculate the Cronbach's alpha which was interpreted for reliability. An alpha value of more than 0.7 was observed for all the variables hence they were regarded as reliable.

CHAPTER FOUR

DATA ANALYSIS, RESULTS AND INTERPRETATION

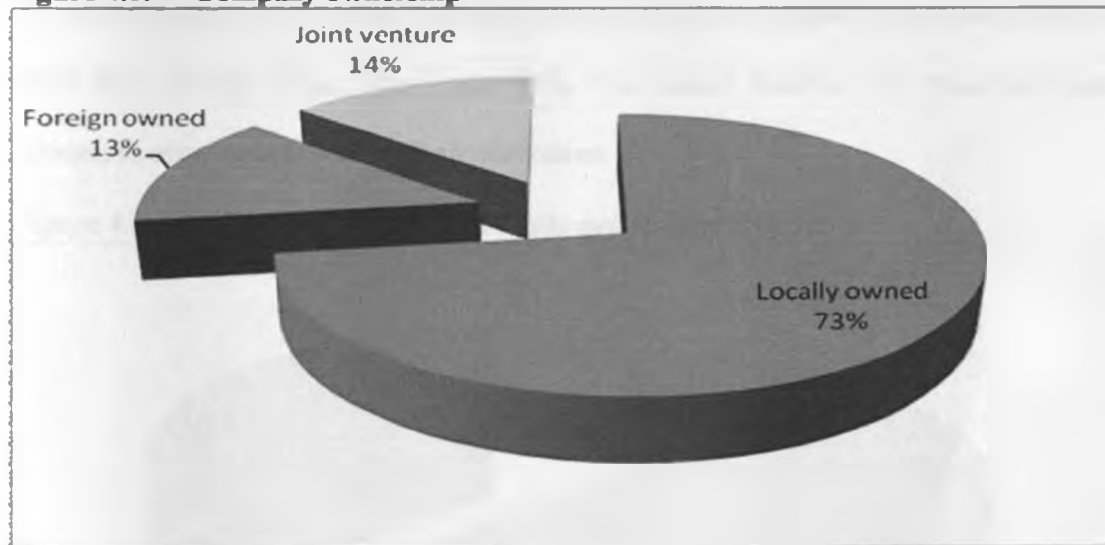
4.1 Introduction

This chapter presents the results of the study. The results are based on responses from 22 companies listed at the Nairobi Securities Exchange out of the 60 firms that were targeted. The response rate was therefore 37%. This is a fairly good response given that this was a survey which usually suffers from lower response rates.

4.2 Sample Characteristics

Table 4.1 shows the ownership of companies that participated in the study.

Figure 4.1: Company ownership

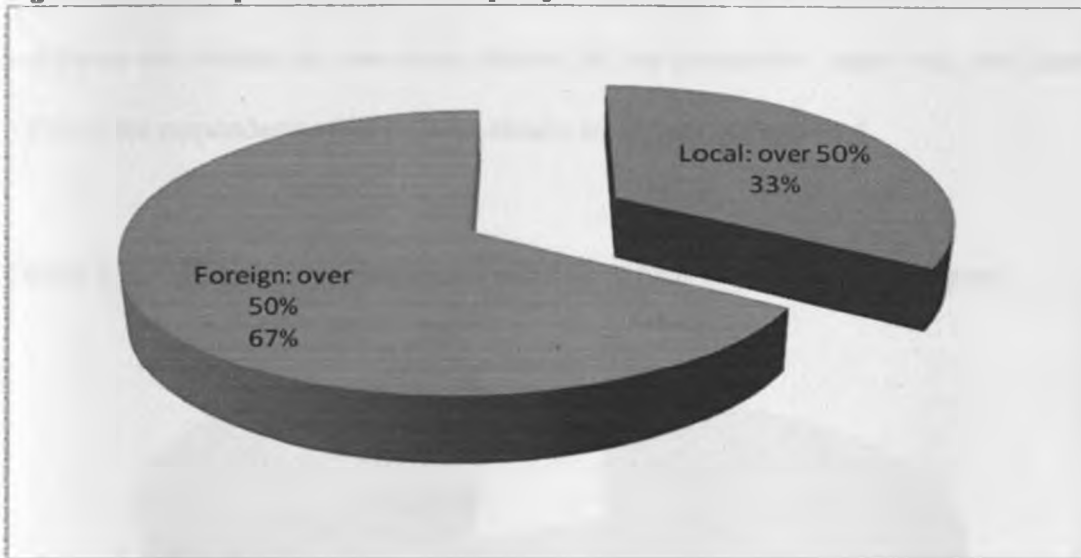


Source: Author (2012)

As shown in Figure 4.1, more than two-thirds (73) of the companies were locally owned.

Figure 4.2 shows the proportion of ownership in joint ventures.

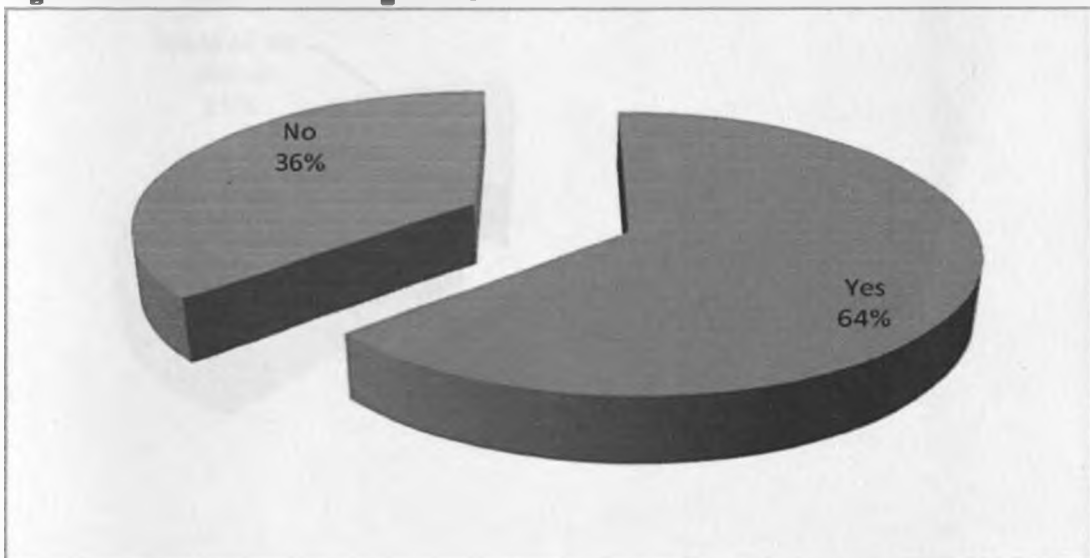
Figure 4.2: Proportion of ownership in joint ventures



Source: Author (2012)

As shown in Figure 4.2, of the 3 companies that were joint ventures, two thirds (67%) of them were foreign firms. The respondents were asked whether the managers were allowed to own some interest in their companies.

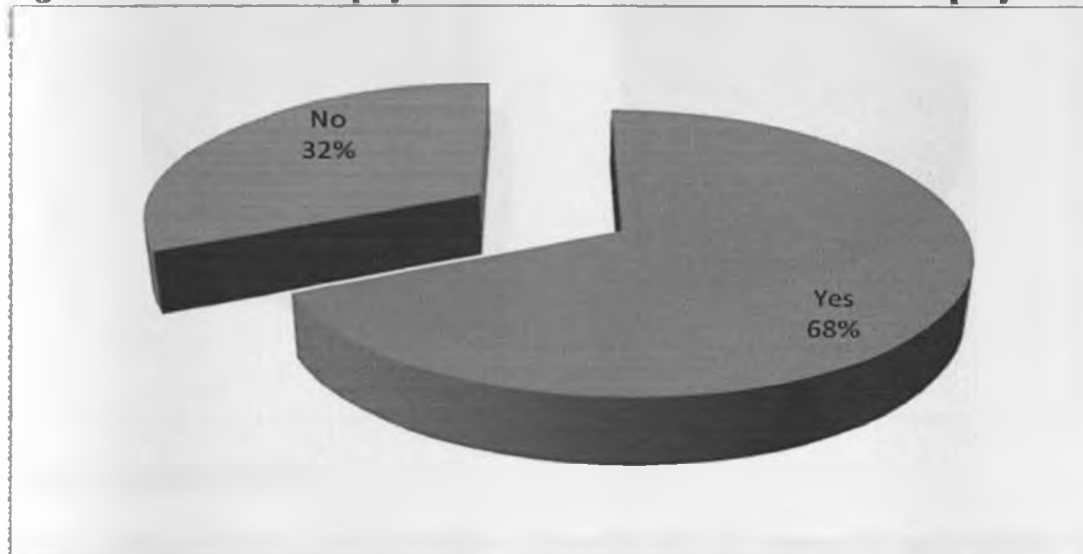
Figure 4.3: Whether management is allowed to own interest



Source: Author (2012)

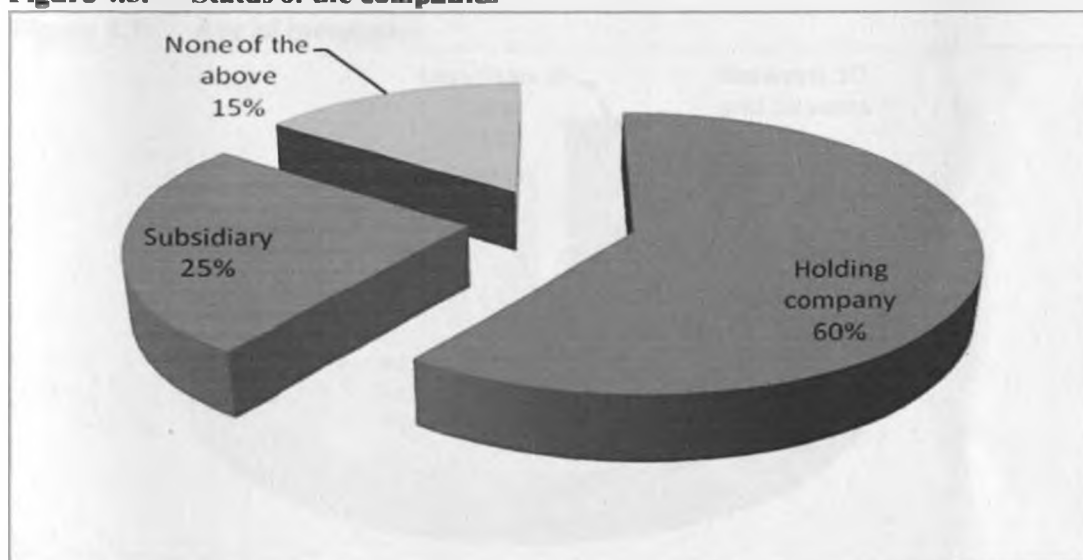
The results in Figure 4.3 show that 64% of the respondents were affirmative. On whether employees are eligible to own some interest in the companies, more than two thirds (68%) of the respondents agreed. These results are shown in Figure 4.4.

Figure 4.4: Whether employees are allowed to own interest in the company



Source: Author (2012)

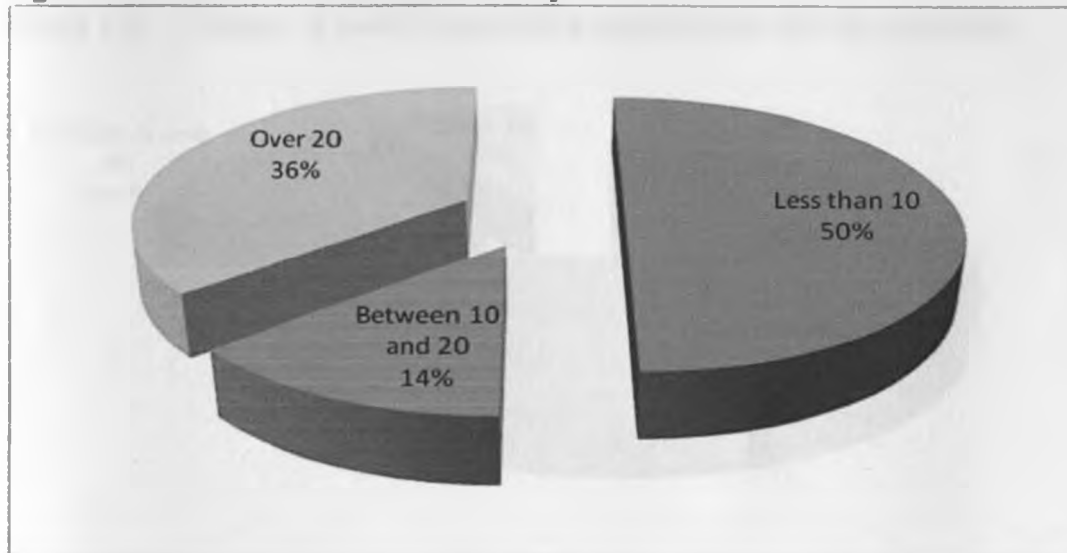
Figure 4.5: Status of the companies



Source: Author (2012)

The study found that 60% of the companies were holding companies and the results are shown in Figure 4.5.

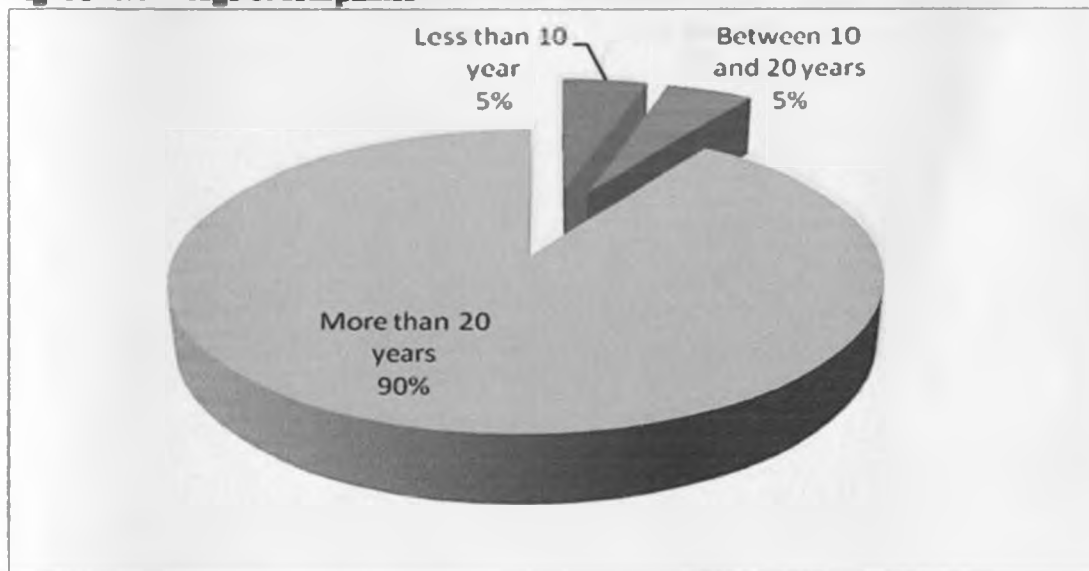
Figure 4.6: Number of branches in Kenya



Source: Author (2012)

Figure 4.6 shows the results of number of branches that the companies had in Kenya. As shown, half of the companies had less than 50 branches.

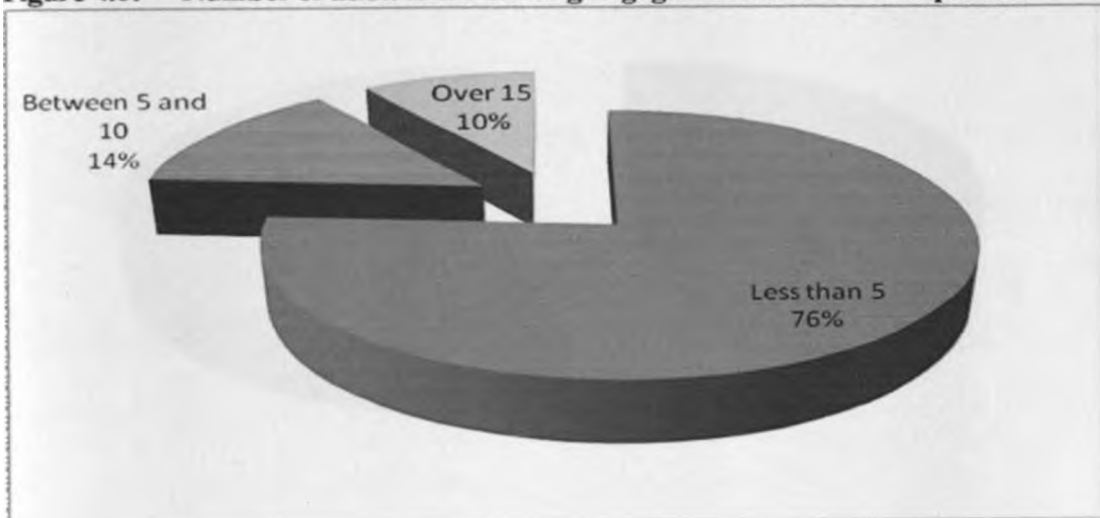
Figure 4.7: Age of companies



Source: Author (2012)

Figure 4.7 shows the age of companies that took part in the study. As shown, 91% of these companies had existed for more than 20 years.

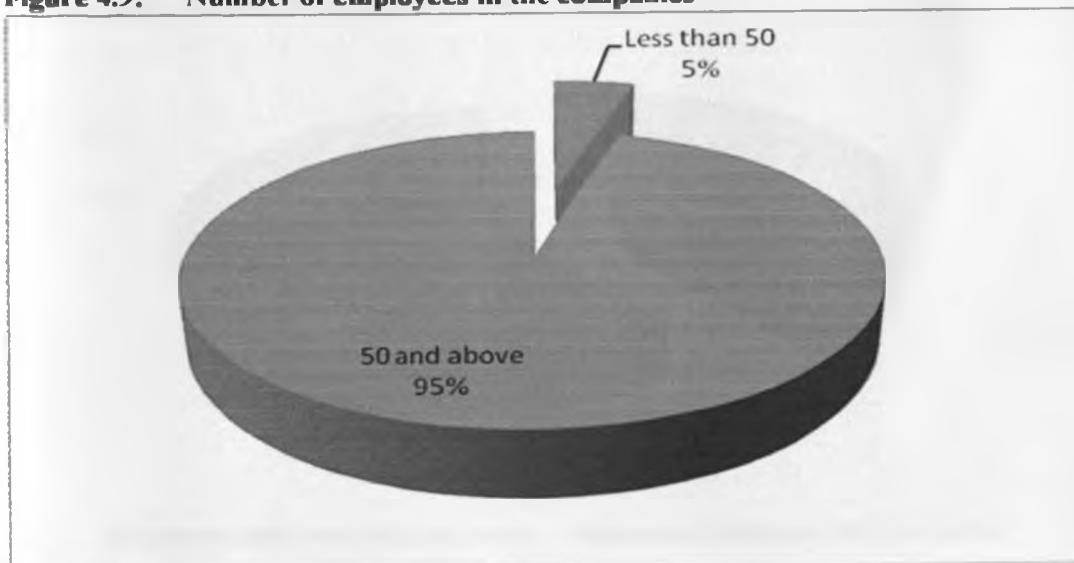
Figure 4.8: Number of audit firms seeking engagements with the companies



Source: Author (2012)

Figure 4.8 shows the number of audit firms that sought engagement from the listed companies. As shown, 76% of the firms said that less than 5 firms did so.

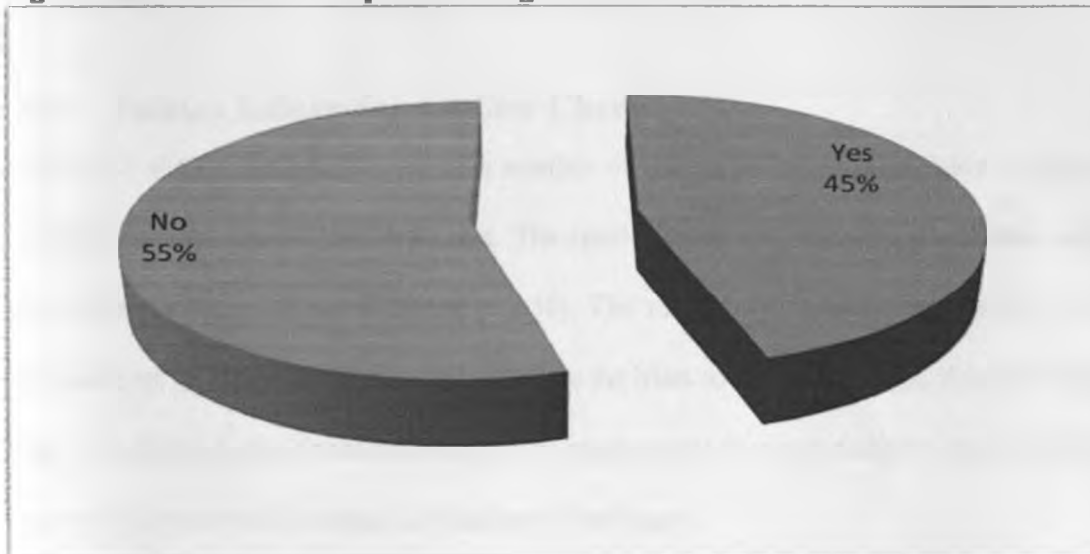
Figure 4.9: Number of employees in the companies



Source: Author (2012)

Figure 4.9 shows the number of employees in the companies that were surveyed. As shown, 96% of the firms had 50 or more employees.

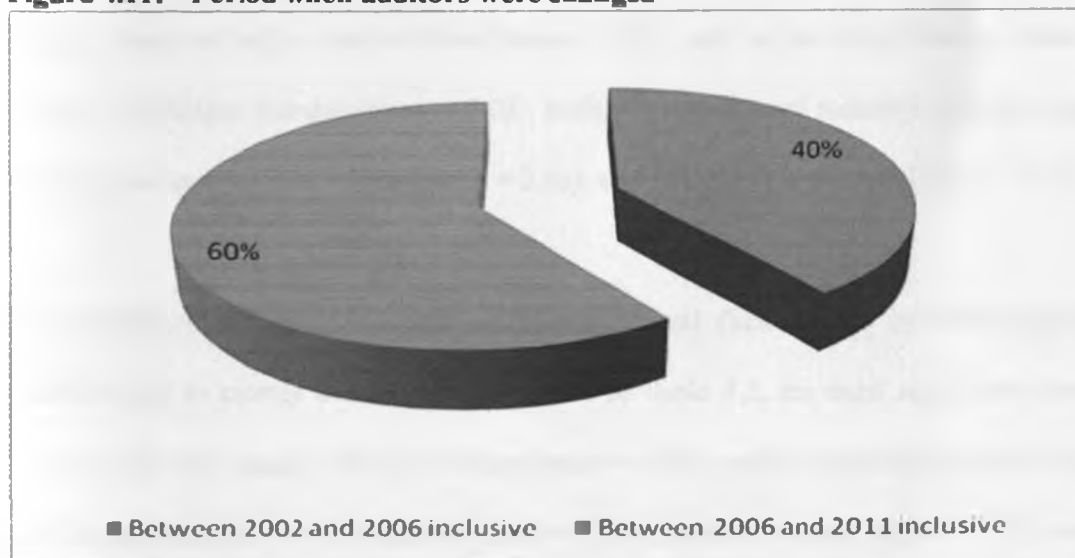
Figure 4.10: Whether companies changed auditors between 2002 and 2011



Source: Author (2012)

Figure 4.10 shows whether the companies changed auditors between 2002 and 2011. As shown, 55% of the companies had not changed their auditors in the period.

Figure 4.11: Period when auditors were changed



Source: Author (2012)

Figure 4.11 shows the period within which the firms changed their auditors. As shown, majority (60%) of the companies changed their auditors between 2006 and 2011 inclusive of the years.

4.3 Factors Influencing Auditor Change

Table 4.1 shows the significance of a number of factors influencing decision to change auditors for the listed firms in Kenya. The results show that the only significant factor was demand by shareholders (mean = 2.50). The rest of the factors were scored by the respondents as insignificant in influencing the decision to change auditors. Another factor that was deemed significant was regulatory requirement to rotate auditors. Some did this every three years while others did this every five years.

Table 4.1 shows the results of factors influencing the decision not to change the auditor. As shown, the most significant factors were satisfactory quality of audit service (mean = 4.00), auditor reputation (mean = 3.91), auditor accessibility for consultation (mean = 3.83), release of audit report in time (mean = 3.66), lack of reporting disputes (mean = 3.16), shareholder demand (mean = 3.08), auditor's unsurpassed industry expertise (mean = 2.83), demand by head office (mean = 2.66), and affordable audit fees (mean = 2.58).

The respondents were asked how significant several factors were in influencing the decision not to change the auditor. As shown in Table 4.2, the most significant factors were satisfactory quality of audit service (mean = 4.00), auditor reputation (mean = 3.91), auditor accessibility for consultation (mean = 3.83), release of audit report in time (mean = 3.66), lack of reporting disputes (mean = 3.16), shareholder demand (mean = 3.08).

auditor's unsurpassed industry expertise (mean = 2.83), demand by head office (mean = 2.66), and affordable audit fees (mean = 2.58).

Table 4.1: Factors influencing auditor change

Factor	N	VS (%)	S (%)	I (%)	VI (%)	Total (%)	Mean	SD
Demanded by shareholders	6	33	17	17	33	100	2.50	1.37
Change of auditor in head office	8	0	50	38	12	100	2.37	0.74
Auditor's lack of industry expertise	8	12	25	38	25	100	2.25	1.03
Management change took place	9	22	22	11	44	100	2.22	1.30
Poor quality of audit service	8	0	25	50	25	100	2.00	0.75
Reporting dispute occurred	6	17	0	33	50	100	1.83	1.16
Qualified opinion was received	6	0	33	17	50	100	1.83	0.98
Unaffordable audit fees	9	11	0	44	44	100	1.77	1.97
Company had liquidity problems	6	0	0	50	50	100	1.50	0.54
Audit firm not among the big 4	6	0	0	50	50	100	1.50	0.54
Poor image/reputation of the audit firms	6	0	0	50	50	100	1.50	0.54

Key: N = Number of responses; VS = Very Significant; S = Significant; I = Insignificant; VI = Very Insignificant

Source: Author (2012)



Table 4.2: Factors influencing no auditor change

Factor	N	VS (%)	S (%)	I (%)	VI (%)	Total (%)	Mean	SD
Satisfactory quality of audit service	12	100	0	0	0	100	4.00	0.00
Auditor has good reputation	12	92	8	0	0	100	3.91	0.28
Auditor is accessible for consultation	12	83	17	0	0	100	3.83	0.38
Auditor releases report in time	12	67	33	0	0	100	3.66	0.49
Lack of reporting disputes	12	25	67	8	0	100	3.16	0.57
Shareholders demand	12	25	58	17	0	100	3.08	0.66
Unsurpassed industry expertise	12	17	58	17	8	100	2.83	0.83
Demand by head office	12	17	50	17	17	100	2.66	0.98
Affordable audit fees	12	8	58	17	17	100	2.58	0.90
Receipt of unqualified audit opinion	12	0	25	50	25	100	2.00	0.73
Tried but unsuccessful	11	9	0	45	45	100	1.72	0.90

Key: N = Number of responses; VS = Very Significant; S = Significant; I = Insignificant; VI = Very Insignificant

Source: Author (2012)

Table 4.3 shows the binary logistic regression analysis results for the study. The table is divided into two sections representing factors for auditor switch and factors for retaining the auditors.

Table 4.3: Determinants of Auditor Switch

To Switch Auditor				Not to Switch Auditor			
Factors	Score	df	Sig.	Factors	Score	df	Sig.
X ₁	1.257	1	.262	X _a	10.476	1	.001
X ₂	2.640	1	.104	X _b	22.000	1	.000
X ₃	4.168	1	.041	X _c	15.278	1	.000
X ₄	5.867	1	.015	X _d	22.000	1	.000
X ₅	1.257	1	.262	X _e	22.000	1	.000
X ₆	2.640	1	.104	X _f	22.000	1	.000
X ₇	5.867	1	.015	X _g	18.333	1	.000
X ₈	4.168	1	.041	X _h	10.476	1	.001
				X _i	2.895	1	.089
				X _j	.873	1	.350
				X _k	12.692	1	.000

Key: X₁ = Unaffordable fees; X₂ = Poor quality; X₃ = Lack of expertise; X₄ = Change in management; X₅ = Reporting dispute; X₆ = Qualified opinion; X₇ = Influence by head office; X₈ = Demand by shareholders; X_a = Affordable fees; X_b = Satisfactory quality of audit; X_c = Demand by Shareholders; X_d = Auditor's good reputation; X_e = Accessibility of auditor; X_f = Timeliness of reports; X_g = Lack of reporting disputes; X_h = Demand by head office; X_i = Unqualified audit opinion; X_j = Unsuccessful trials; X_k = Unsurpassed industry expertise.

Source: Author (2012)

A logistic regression was run given that the dependent variable (auditor switch) was binary. The model is as summarized below:

$$Y_1 = 1.257X_1 + 2.64X_2 + 4.168X_3 + 5.867X_4 + 1.257X_5 + 2.64X_6 + 5.867X_7 + 4.168X_8$$

$$Y_2 = 10.476X_a + 22X_b + 15.278X_c + 22X_d + 22X_e + 22X_f + 18.333X_g + 10.476X_h + 2.895X_i + 0.873X_j + 12.692X_k$$

The results show that the determinants of auditor switch were auditor's lack of industry expertise, management change, change of auditor at the head office, and demand by the shareholders. All these factors had significance values of less than 5% suggesting that the factors were significant.

On the other hand, the results suggest that the factors that significantly informed firms not to switch auditors were affordable fees, satisfactory quality of audit, shareholders demand, auditor's good reputation, accessibility of auditor, timeliness of audit report, lack of reporting disputes, demand by the head office, and unsurpassed industry expertise. All these variables had p-values of $< 5\%$ suggesting that they were significant determinants not to change auditors.

4.4 Discussion of Findings

The study sought to examine the determinants of auditor change among companies listed at the Nairobi Securities Exchange. The results show that the determinants of auditor switch were auditor's lack of industry expertise, management change, change of auditor at the head office, and demand by the shareholders.

All these factors had significance values of less than 5% suggesting that the factors were significant. These results are consistent with empirical evidence from other scholars who have studied the same. The results confirm that firm specific factors, auditor specific factors, and key stakeholder factors influence the change of auditors by listed firms in Kenya.

The study also found that there are a number of factors that significantly influenced firms' decisions not to switch auditors. These factors include affordable fees, satisfactory quality of audit, shareholders demand, auditor's good reputation, accessibility of auditor, timeliness of audit report, lack of reporting disputes, demand by the head office, and unsurpassed industry expertise.

The results are consistent with theory and empirical evidence from various studies. The results confirm that firm specific factors, auditor specific factors, and key stakeholder factors influence the decision by listed firms in Kenya not to change auditors.

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter presents the summary of study findings, conclusions of the study, recommendations for policy, limitations of the study, and suggestions for further research.

5.2 Summary of Study Findings

This study intended to establish the determinants of auditor changes for listed companies in Kenya. Descriptive results showed that the major factors were satisfactory quality of audit service (mean = 4.00), auditor reputation (mean = 3.91), auditor accessibility for consultation (mean = 3.83), release of audit report in time (mean = 3.66), lack of reporting disputes (mean = 3.16), shareholder demand (mean = 3.08), auditor's unsurpassed industry expertise (mean = 2.83), demand by head office (mean = 2.66), and affordable audit fees (mean = 2.58).

The descriptive results showed that the most significant factors influencing the decision not to change auditors were satisfactory quality of audit service (mean = 4.00), auditor reputation (mean = 3.91), auditor accessibility for consultation (mean = 3.83), release of audit report in time (mean = 3.66), lack of reporting disputes (mean = 3.16), shareholder demand (mean = 3.08), auditor's unsurpassed industry expertise (mean = 2.83), demand by head office (mean = 2.66), and affordable audit fees (mean = 2.58).

Further, regression analysis showed that the determinants of auditor switch were auditor's lack of industry expertise, management change, change of auditor at the head office, and demand by the shareholders. On the other hand, the factors that significantly informed firms not to switch auditors were affordable fees, satisfactory quality of audit, shareholders demand, auditor's good reputation, accessibility of auditor, timeliness of audit report, lack of reporting disputes, demand by the head office, and unsurpassed industry expertise.

5.3 Conclusion

The study concludes that other than the mandatory rotation requirement for listed firms, there are a number of factors that influence auditor change. Firms are more likely to change the auditor if the auditor lacks industry expertise. Additionally, where there has been a change in management, it is likely that a decision may be made by the firm to change the auditor. Furthermore, for firms that operate as subsidiaries of other firms located outside the country, a change of auditors at the head office may also lead to a change of auditor in the subsidiary company. Lastly, the major reason for change of auditor was found to be the demand by the shareholders. During AGMs, shareholders might demand that the auditors be changed.

The study also concludes that there are a number of factors that influence firms' decision not to change auditors. One of the factors is affordable fees. Thus when firms perceive the fees charged by the audit firm as affordable, they tend to retain the auditor. Secondly, satisfactory quality of audit also influences the decision not to change auditor. Where the client (listed firm) is satisfied with the quality of work done, they tend to retain the audit

firm. Thirdly, the shareholders may also demand that the auditors be retained during an AGM and therefore they are a significant force in that regard. Another reason that may help retain an auditor is the auditor's good reputation. Other reasons include accessibility of auditor, timeliness of audit report, lack of reporting disputes, demand by the head office, and unsurpassed industry expertise.

5.4 Recommendations for Policy

These findings have important implications for audit firms operating in Kenya. First, audit firms should ensure that their expertise as regards advisory and audit to various industries is impeccable if they are to be retained by their clients. This can be done by gaining knowledge and experience through auditing and offering advisory services to various industries over time.

Audit firms also need to charge fees that are affordable to firms as this is a major determinant of their retention. Further, audit firms should endeavor to do quality audits, maintain good reputation, be accessible to clients for any consultations, and present audit reports in time.

5.5 Limitations of the Study

The study only focused on listed firms at the Nairobi Securities Exchange and therefore the results need to be interpreted with this in mind. Interpretations outside this scope should be approached with care.

The study also used primary data in gathering information that was used in the analysis. The study therefore suffers from the limitations of primary data in this regards. This is because the information gathered here was not corroborated with any secondary sources.

5.6 Suggestions for Further Research

The study suggests that further studies be done where triangulation with secondary data through memos or any other available and relevant secondary data can be done in order to establish the determinants of auditor changes by listed companies in Kenya.

The study also recommends that this study be replicated to other specific industries such and especially the unlisted firms that are not inclined to choose from the Big 4 audit firms in order to understand their choice of auditors and the determinants of retention or switch of auditors.

Lastly, the study suggests that another study be carried out for listed firms to establish the relationship between auditor switch and company performance. This will help identify whether there are strategic reasons for switching auditors.

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APPENDIX

Appendix A: Listed companies in the Nairobi Securities Exchange

1. A.Baumann and Company
2. AccessKenya Group
3. Athi River Mining
4. B.O.C Kenya
5. Bamburi Cement
6. Barclays Bank
7. British American Investments
8. British American Tobacco Kenya
9. CFC Insurance Holdings
10. CFC Stanbic Holdings
11. CIC Insurance Group
12. CMC Holdings
13. Car and General (K)
14. Carbacid Investments
15. Centum Investment Company
16. City Trust
17. Co-operative Bank of Kenya
18. Crown Berger
19. Diamond Trust Bank Kenya
20. E.A.Cables
21. E.A.Portland Cement
22. Eaagads
23. East African Breweries
24. Equity Bank
25. Eveready East Africa
26. Express
27. Housing Finance Company
28. Hutchings Biemer
29. Jubilee Holdings
30. Kakuzi
31. Kapchorua Tea Company
32. KenGen
33. KenolKobil
34. Kenya Airways
35. Kenya Commercial Bank
36. Kenya Orchards
37. Kenya Power and Lighting
38. Kenya Re Corporation
39. Limuru Tea Company
40. Longhorn Kenya
41. Marshalls (E.A.)
42. Mumias Sugar Company

43. NIC Bank
44. Nation Media Group
45. National Bank of Kenya
46. Olympia Capital Holdings
47. Pan Africa Insurance Holdings
48. Rea Vipingo Plantations
49. Safaricom
50. Sameer Africa
51. Sasini Tea and Coffee
52. ScanGroup
53. Standard Chartered Bank
54. Standard Group
55. TPS Eastern Africa (Serena)
56. Trans-Century
57. Total Kenya
58. Uchumi Supermarket
59. Unga Group
60. Williamson Tea Kenya

Appendix B: Introductory Letter

Dear Sir/Madam,

I am a post graduate student at the University of Nairobi. I am conducting a research entitled “Determinants of auditor change among companies listed on Nairobi Securities Exchange”. Your company has been selected for the study.

I kindly request you complete the questionnaire to the best of your knowledge. Information requested is required purely for academic purposes and will be treated in strict confidence. In no instance will the name of your company appear in the final report.

Any additional information you feel is necessary for this study is welcome and can be written on the back of the questionnaire.

A copy of final report will be made on request. Your cooperation will be greatly appreciated.

Thank you in advance

Yours sincerely,

Kenneth C. Amdany

Appendix C: SURVEY QUESTIONNAIRE

To be filled by the Finance Director or his equivalent in the company.

Please kindly answer the following questions by placing a tick (✓) in the spaces provided and or/ giving details as may be required. The questionnaire was developed from the pertinent literature.

SECTION 1 : GENERAL

1 (a) How would you classify your company with regard to ownership?

- (i) Locally owned []
- (ii) Foreign owned []
- (iii) Joint venture []

(b) For the classification (iii) above, what is the proportion of ownership?

- (i) Local : Over 50% []
- (ii) Foreign: Over 50% []

(c) Are those in management allowed to own some interest in the company?

- (i) Yes []
- (ii) No []

(d) Are employees eligible to own some interest in your company?

- (i) Yes []
- (ii) No []

2. Status of your company

- (i) Holding company []
 - (ii) Subsidiary []
 - (iii) None of the above []
3. Number of your company branches in Kenya
- (i) Less than 10 []
 - (ii) Between 10 and 20 []
 - (iii) Over 20 []
4. How long has the company been in existence?
- (i) Less than 10 years []
 - (ii) Between 10 and 20 years []
 - (iii) More than 20 years []
5. How many audit firms seek audit engagements from your company
- (i) Less than 5 []
 - (ii) Between 5 and 10 []
 - (iii) Between 10 and 15 []
 - (iv) Over 15 []
6. Number of employees in your company
- (i) Less than 50 []
 - (ii) 50 and above []
7. Did your company change auditors between 2002 and 2011?
- (i) Yes []
 - (ii) No []

SECTION B: FOR FIRMS THAT CHANGED AUDITORS BETWEEN 2002 AND

2011

8. In which year did the company change the auditors?

(i) Between 2002 and 2006 inclusive

(ii) Between 2007 and 2011 inclusive

9. How significant were the following factors in influencing your decision to change the auditor

Factor	Very Significant	Significant	Insignificant	Very insignificant
(i) Unaffordable audit fees	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
(ii) Poor quality of audit service	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
(iii) Auditor's lack of industry expertise	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
(iv) Management change took place	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
(v) Reporting dispute occurred	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
(vi) Qualified opinion was received	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
(vii) Company had liquidity problems	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
(viii) Audit firm not among the big 4	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
(ix) Poor image/reputation of the audit firms	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
(x) Change of auditor in head office	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
(xi) Demanded by shareholders	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
(xii) Other (specify).....				

END.

THANK YOU FOR YOUR COOPERATION

SECTION C: FOR FIRMS THAT DID NOT CHANGE AUDITORS

10. How significant have the following factors been in influencing the decision not to change the auditor?

Factor	Very Significant	Significant	Insignificant	Very insignificant
(i) Affordable audit fees	[]	[]	[]	[]
(ii) Satisfactory quality of audit service	[]	[]	[]	[]
(iii) Shareholders demand	[]	[]	[]	[]
(iv) Auditor has good reputation	[]	[]	[]	[]
(v) Auditor is accessible for consultation	[]	[]	[]	[]
(vi) Auditor releases report in time	[]	[]	[]	[]
(vii) Lack of reporting disputes	[]	[]	[]	[]
(viii) Demand by head office	[]	[]	[]	[]
(ix) Receipt of unqualified audit opinion	[]	[]	[]	[]
(x) Tried but unsuccessful	[]	[]	[]	[]
(xi) Unsurpassed industry expertise	[]	[]	[]	[]
(xii) Other (specify).....				

END.

THANK YOU FOR YOUR COOPERATION

Appendix D: Summary of Past Research Studies

	Author(Yr)	Title	Objectives	Methodology	Findings
1.	Chow and Rice (1982)	Qualified Audit Opinions and Auditor Switching.	To determine the influence of qualified audit opinions on auditor switches.	Data for the study was obtained for 9,460 companies that had qualified opinions in 1973 and changed auditors between the 1973 and 1974 fiscal year-ends The conditional logit model was formulated for analyzing the effect of the variables on auditor changes	The study supported the contention that firms switch auditors more frequently after receiving qualified audit opinions
2.	Roberts et al (1990)	Determinants of auditor change in public sector	To determine the factors that influence auditor changes in public school districts in Texas	The study examined the effect of audit fees, internal control weaknesses, change of superintendent in the preceding years, and school board noncompliance with reporting standards. The study employed a stepwise logistic regression model to test the relation between auditor change and the explanatory variables.	Audit fees, reports of material internal control weaknesses, and the school boards noncompliance with laws and regulations governing financial reporting were significantly related to auditor change in public sector.
3.	Kemei (1992)	The determinants of auditor changes by unquoted companies operating in Nairobi	To determine the factors that influence auditor changes by unquoted companies operating in Nairobi.	Population of study comprised all the unquoted companies operating in Nairobi. A sample of 100 firms out of 25,463 was selected covering the period 1981-1990. Primary data was collected using a questionnaire. Association of 15 factors on auditor switch were analyzed. Conditional logit model and correlation analysis were used for data analysis.	Quality of audit service was very significant in explaining auditor switching, organization complexity, size and financial distress were also significant in explaining auditor changes.
4.	Beattie, Goodacre and Masocha	The Determinants of Auditor Changes in the Voluntary Sector: Evidence from UK	To investigate the generalisability of auditor change determinant models developed in the private sector	Study examined the effect of management change, change in financing, charity reputation, auditor quality and audit fees	Charities were more likely to change auditor if the incumbent auditor was 'top tier', if the new auditor had greater expertise in the charity sector,

	Author(Yr)	Title	Objectives	Methodology	Findings
	(2006)	Charities	and to identify factors that are peculiar to the charity sector	They developed a logit regression model of the determinants of auditor change	if the charity had an audit committee and if the charity income had fallen significantly
5.	Mutiga (2006)	The perceived role of the external auditor in corporate governance	1) To determine the role of the external auditor in corporate governance of corporations 2) To establish the extent to which users of financial statements perceive that the auditor should make a report on corporate governance of a corporation	Research design was a survey. Data was collected by means of a semi structured interview using a questionnaire with auditors on current audit practise. Data was analyzed using content analysis and descriptive statistics. Population was the registered auditors in Kenya, shareholder, institutional investors and the regulatory agencies. Random sampling was used. The study targeted a sample of 50 registered audit firms.	Auditors view management as the primary driver of corporate governance. Auditors consider corporate governance factors to be especially important in the client acceptance phase and in an international context. The shareholders and regulators on the other hand regard inclusion of a paragraph on corporate governance in the audit report.
6.	Kibara (2007)	A survey of internal auditors risk management practices in the banking industry in Kenya	1) To establish the internal auditors perception of their distinct role as opposed to that being played by the risk management department 2) To establish internal auditors risk assessment practices in banks in Kenya	Survey approach. Study used a structured questionnaire to gather primary data required for the study. Target for the study was all the 44 banks in Kenya licenced under the banking act (Cap 488).	Seven banks out of twenty one (33%) had not established a separate risk management department. Only 14% of the internal auditors could clearly list the distinct role of IAD and those of RMD.
7.	Murithi (2009)	A survey of the role of internal auditors in enterprise-wide risk management for listed companies in Kenya (Industrial and Allied sector)	To survey the role of internal auditors in Enterprise-wide Risk management (ERM) for quoted industrial and allied sector companies in Kenya	Research design was descriptive. Primary data was collected using mail questionnaire. Data was analyzed by use of descriptive statistics such as proportions, percentages, means and frequency distributions. Population consisted all 18 companies listed at the NSE under industrial and Allied sector as at 31 December 2008.	Kenya's industrial and allied sector companies are yet to adopt ERM and the internal auditor is doing a bulk of the ERM work instead of all the stakeholders being involved in risk management
8.	Lin and Liu (2010)	Determinants of auditor switch from the Perspective of	To investigate the association between firms' internal corporate governance	Three variables were used to proxy for firms' internal corporate governance mechanism, including the ownership concentration	Firms with weak internal corporate governance mechanism tend to switch to smaller or more pliable auditors in

	Author(Yr)	Title	Objectives	Methodology	Findings
		corporate governance in China	mechanism and their auditor switch decisions	(shareholding by the largest owner), the effectiveness of supervisory board (SB), and the duality of chairman of board of directors (BoD) and CEO. Logistic regression model was used in the study.	order to sustain the opaqueness gains derived from weak corporate governance
9.	Chadegani, Mohamed and Jari (2011)	The determinant factors of auditor switch among companies listed on Tehran Stock Exchange	1) To determine whether auditor related factors (auditor fees, auditor opinion, audit quality) influence auditor switch. 2) To determine whether client related factors (client size, changing management, financial distress) influence auditor switch.	6 factors were analyzed namely, audit fees, auditor opinion, audit quality, client size, changing management and financial distress. A sample of 182 companies that listed on TSE) was selected. Logistic regression model was used in the study	Between 6 factors that were analyzed, only auditor size was significantly related to auditor switch among companies listed on Tehran Stock Exchange.
10.	Sulfiyah (2011)	Analysis of auditor relations - client: factors - factors affecting the auditor's switching in Indonesia (case study in the service sector stock exchange listed in Indonesia).	To determine the factors affecting companies in Indonesia to auditor switching	The variables used in the study were change management, firm size, firm growth, financial distress, previous audit opinion and audit fees. The data used was financial statement data of service sector companies listed in the Indonesia Stock Exchange (IDX) from year 2005 to 2010 The hypothesis was tested using regression analysis.	Variables that significantly influence auditor switching are a change of management, previous audit opinion and audit fees. The other variables in the study such as firm size, growth and financial distress were not seen to affect auditor switching.