DETERMINANTS OF CHOICE OF EXTERNAL AUDITORS:

THE CASE OF COMMERCIAL BANKS IN KENYA

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DECLARATION

I declare that this is my original work and has not been presented for award of any degree in any university.

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My appreciation goes to the many people who in different and varied ways helped me in the development and completion of this project.

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To all other people who in one way or another assisted me I will forever be grateful to you and may God bless you in a mighty way.

DEDICATION

I dedicate this study to my dear parents who against all odds ensured I got the best upbringing and from whom I have learned the virtues of hard work and persistence.

ABSTRACT

The study was carried out with a view to establish the determinants of choice of external auditors by commercial banks in Kenya. Due to several scandals of different magnitude, the interest of researchers, companies as well as of the general public in corporate governance has grown during the past few years. Many researchers have attempted to investigate the many possibilities a company has to be responsible in its day to day operations.

Secondary data was collected from Central Bank of Kenya and Commercial banks financial statements. The tool used to analyze the data was regression analysis where an appropriate model was formed to analyze the relationship between auditor choice and other factors such as audit fees, size of banks in terms of asset base and whether the bank is listed or not.

The study reaches a conclusion that choice of external auditors is unaffected by external audit fees charged. Thus external audit fees have not had a significant influence on the choice of external auditors for commercial banks in Kenya. In addition, Asset base of a bank had no significant influence on the choice external auditors The study also concludes that listing status of a bank was also not a significant determinant of choice of external auditors. A strong positive correlation was however noted between the choice of a Big 4 audit firm and level of audit fees indicating that Big 4 audit firms charge high fees. The study recommends that banks should evaluate the quality of the auditor before selection and unless high quality can be attributed to hiring a Big 4 audit firm, it is cost efficient to hire a small audit firm.

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ABBREVIATIONS

ATM	-	Automated Teller Machine
CBK	-	Central Bank of Kenya
ICPAK	-	Institute of Certified Accountants, Kenya
IFAC	-	International Federation of Accountants
NSE	-	Nairobi Securities Exchange
RAB	-	Registration of Accountancy Board
UNCTDA	-	United Nations Conference on Trade and Development

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CHAPTER ONE

INTRODUCTION

1.1. Background of the Study

Due to several scandals of different magnitude, the interest of researchers, companies as well as of the general public in corporate governance has grown during the past few years. Many researchers have tried to investigate the many strategies that an organization could adopt so as to be responsible. One of these corporate governance mechanisms available to companies, mentioned by Broye and Weill (2008) and earlier suggested by Watts and Zimmerman (1986), is the hiring of auditors. Having the option to choose from a wide range of audit firms, and because company managers experience several incentives in making such a choice, whether or not to choose a particular auditor. Corporate governance decisions have been the subject of many previous studies. However, the debate concerning the determinants of choice of external auditors is still ongoing.

1.1.1. External Auditing

Collis et al (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 researcher adopts International Federation of Accountants (IFAC, 2005), definition of external audit as 'an independent examination of, and the subsequent expression of opinion on, the financial statements of an organization'. From an agency perspective (Nikkinen et al, 2004) the demand for audited financial statements arises from information asymmetry, on the assumption that human nature is weak, untrustworthy and in need of some kind of checking (Justin et al, 2006).The requirement for annual audit is in fact, the owners' initiatives in monitoring the activities of their managers in handling financial matters of the company. In addition, audited accounts are a source for the owner to derive the financial information of their company (Arfah et al, 2008).

1.1.2 Factors Influencing Choice of an External Audit Firm

Knechel et al (2008) argue that choice of an audit firm is usually based on a consideration of the quality of the auditor as well as cost. Banks therefore consider their needs and then seek an auditor with the requisite skills and competencies to provide practical solutions. Cost is also a determinant factor when evaluating proposals from external auditors. Francis and Simon (1987) found out that when selecting audit firms, organizations evaluate marginal costs for engaging a Big Four auditor, sentiments which were also echoed by El Ghoul et al (2007). They argued that when an organization is seeking to improve the quality of its disclosures, it will be eager to hire a Big Four auditor. However Porter (2009) observes that where qualified accountants are hired, improvement in disclosure requirement could be carried out in-house thus making it unnecessary to hire a Big Four firm since these firms at times charge higher audit fees compared to their peers.

Al-Bawab (2012) observes that the major consideration for selection of external auditors is the regulatory requirements. Some countries have legislations which govern choice and selection of external auditors. However, where no such legal requirements are faced, Sands and Huang (2002) found out that the major consideration in choice of audit firms is quality of the auditor as well as audit fees. They argued that when reviewing proposals of prospective auditors, organizations often consider the past experience in the industry, availability of staff with professional qualifications required as well as the prospective auditor's external quality reviews. Hay and Davis (2004) advise that the personnel to perform an external audit should have experience in audits of similar entities as well as continuous professional education. The World Bank (2010) regrets that the multiple certifications required for banks' external auditors through vetting by ICPAK and CBK have a disproportionate impact on competition. Big Four audit firms have therefore been gaining market share at the expense of local firms. Big audit firms are hence favored by the current legislation giving them dominance in regulated industries such as banks and insurance companies. Hay and Davis (2004) proposes auditor choice in a modern voluntary audit setting, where entities choose an audit of any level of quality namely auditor reputation, auditor size, auditor professional institute membership and auditor education. They note that successive choice of a higher quality auditor show that greater entity size is associated with the choice of a higher level of audit quality. Small entities on the other hand, should choose equally small audit firms which are cheaper in most cases. However, Shiong (2008) notes that, while it could be more cost-effective for small enterprises to engage smaller audit firms, there are benefits in engaging an international accounting firm, as the latter have international networks, sophisticated infrastructure, resources and the business and technical knowledge to meet the needs of fast-expanding small and medium tier banks.

According to the Kenyan Banking Act, appointment of external auditors in commercial banks should be carried out by the audit committee which is a sub-committee of the Board of Directors. Confirmation of an appointed auditor should however be done by shareholders in an annual general meeting. Barako (2007) therefore observes that commercial banks in Kenya have the liberty in selection of audit firms. They are also required to hire qualified internal audit staff by the CBK Prudential Guidelines as well as the Banking Act. However, a majority still engage Big Four audit firms despite their relatively higher audit fees. There is therefore need to understand motivations behind this phenomenon. The factors considered made by commercial banks when hiring audit firms therefore forms the basis of this study.

Commercial banks play a critical role as an intermediary between lenders and borrowers. They also help in promotion of investments and savings in a country. Souter et al (1995) found out that there is a strong relationship between the strength of a financial system in a country and economic development. They noted that where a strong financial system exists, investors will easily access financing for their projects while savers get an opportunity to grow savings useful for future investment. Kenya has had a very poor banking history with the collapse of a number of local banks in the early 1990's such as Delphis Bank, Euro Bank, Trade Bank, and Exchange Bank. This forced the CBK to come up with stringent measures referred to as the CBK Prudential Guidelines to improve internal control systems in the banking sector. Among other things, the guidelines made it mandatory for commercial banks to engage qualified audit firms vetted by CBK to carry out financial audits for banks. Commercial banks were however given the mandate to make a choice of auditors provided they are registered practicing accountants by RAB (CBK 2006).

The Kenyan Companies Act sets the general framework for financial accounting and reporting by all registered companies in Kenya, and stipulates the basic minimum requirements with regard to financial reporting. Barako et al (2006) argue that because of the limited details of the Act, financial reporting and regulation is supplemented by International Financial Reporting Standards. Financial reporting in commercial banks is influenced by the CBK prudential guidelines as well as the Kenyan Banking Act. CBK regulates the form and mode of reporting. Section 24 of the Banking Act requires external auditors to be appointed on an annual basis. Only qualified auditors should be appointed subject to vetting by CBK. Qualifications required are spelt out in section 161 of the Companies Act which limits appointment of an auditor to a person with a practicing certificate as per section 21 of the Kenyan Accountants Act. Despite having more than 760 practicing accountants in Kenya as at the end of year 2012 (ICPAK 2012), only four of the registered accounting firms that controlled more than 90 percent of audits in Kenya's commercial banks. This study sought to find out the determinants of choice of external auditors in Kenyan commercial banks.

1.1.3. Commercial Banking

A commercial bank is a financial institution that provides services, such as accepting deposits, giving business loans and auto loans, mortgage lending, and basic investment products like savings accounts and certificates of deposit. The traditional commercial bank is a brick and mortar institution with tellers, safe deposit boxes, vaults and ATMs. However, some commercial banks do not have any physical branches and require consumers to complete all transactions by phone or Internet. In exchange, they generally pay higher interest rates on investments and deposits, and charge lower fees. Commercial banking activities are different from those of investment banking, which include underwriting, acting as an intermediary between an issuer of securities and the investing public, facilitating mergers and other corporate reorganizations, and also acting as a broker for institutional clients. As at the close of year 2011, there were 44 registered commercial banks in Kenya which formed the sample for this study.

1.1.4 Audit Firms in Kenya

The "Big Four" accounting firms account for a third of the industry's worldwide revenues in accounting and auditing, and in auditing they generate 67 per cent of global revenues UNCTAD (2004). Mwaura (2007) notes that these accountancy firms heavily dominate the professional services sector in Kenya, controlling about 80 percent of all large and public consultancies. These firms namely, PriceWaterHouse Coopers, Ernst & Young, Deloitte, and KPMG were engaged by 39 out of the 42 commercial banks in Kenya in year 2011 (See Appendix 1). Barako (2007) observed that by the end of year 2001, an overwhelming 91 percent of listed companies were using the services of big-four audit firms up from 33 percent in 1991. He found out that big four audit firms have higher extent of voluntary disclosures as compared to the small and medium tier accountancy firms. Dihel et al (2010) reached similar conclusion noting that accounting and auditing services in all the three East African countries are dominated by the Big Four multinational accountancy firms.

Iskandar et al (2010) found out that quality of audit services vary depending with the size of audit firms. They argue that big audit firms represent high quality whereas small audit firms represent low quality audit. Behn et al (1997) supports this view arguing that Big Four firms have resources needed to invest in better technology and training of staff members and thus have developed a reputation and expertise among their clients. Further, they continuously provide high quality services so as to maintain their reputation and market share. Khurana and Raman (2004) however hold a totally different view arguing that in an environment with less litigation risk, Big Four auditors do not have any incentive to provide high quality audits. They found out that there is no significant difference between quality of audits offered by the Big Four audit firms and those offered by small firms. Choi et al (2008) observed that Big Four audit firms charge higher audit fees relative to their peers which they argued that this was synonymous with the quality of services they offer. In Kenya, Big Four audit firms are among the best paying organizations. Herblig (2012) observed that these costs are passed on to clients in form of high fees. Engaging a Big Four audit firm is therefore expensive which could only be justified by quality of services offered. As such, where the quality of services offered is not different from those of small firms, using Big Fours might be unnecessary.

1.2 Statement of the Problem

Knechel et al (2008) observed that there are two determinants of the choice of an auditor, that is; quality factors and cost. Quality factors mainly relate to the need to reduce agency problems by engaging an auditor who cannot be easily compromised by management and thus ensuring credibility of audit conclusions. Banking institutions are required by the CBK Prudential Guidelines to observe good corporate governance practices aimed at improving internal control systems such as having non-executive directors, hiring independent board members, maintaining capital adequacy and not carrying out prohibited businesses. In addition, they are expected to have an audit committee of the Board where internal auditors should report. Therefore, Chepkorir (2010) found out that there are a number of internal checks and balances to ensure that strong corporate governance practices are observed.

Improvement in corporate governance through hiring internal auditors and audit committees in Kenyan companies has interested a number of researchers. For instance, Chepkorir (2010) found out that internal auditors in Kenyan banking industry comprise of qualified professionals as per the requirement of the CBK prudential guidelines. Therefore, she concluded that having an effective internal audit function is critical in minimizing agency problem. However, the researcher did not evaluate whether hiring big audit firms such as the Big Four is important where there is an effective internal audit function. Oriku (2010) underscored the importance of having an effective audit committee in promotion of corporate governance in the Constituency Development Fund though he did not address the importance of external auditors in upholding strong internal controls. Kimani (2006) and Mutiga (2006) found out that the main role of external auditors is to improve corporate governance practices of an entity thus complementing internal auditors. Where internal audit function is effective, one would therefore argue that having high quality external audit would simply lead to duplication of effort. Engaging Big Four audit firms in Kenyan commercial banks where it is mandatory for players to maintain a strong internal audit function, might therefore be an unnecessary though costly practice.

Whereas external auditors are vetted by CBK, banks have the discretion in selection of external auditors provided they are registered with RAB and accredited by CBK. In the year 2012, there were 760 qualified audit firms (ICPAK 2012). However, despite the numerous qualified external audit firms in the country, the Big Four audit firms were appointed by more than 90 percent of the commercial banks in Kenya even though they tended to be costly than their peers. A number of studies have been carried out to determine the considerations made by organizations when choosing external audit firms for instance by Broye and Weill (2008) who found out that highly leveraged firms are likely to engage high quality auditors. Hay and Davis (2004) recommended that organizations should be left to choose audit of any quality whereas (Knechel et al, 2008) found out that engaging big audit firms is inappropriate for small firms. Al-Bawab (2012) is the only researcher who specifically studied the determinants of choice of external audit firms among banking institutions in Jordan. The main study gap in the research is that it focused on the perspective of external auditors with no consideration of the views of persons involved in vetting and selection of external auditors in banks such as the audit committee.

Whereas the practice of hiring Big Four firms is very common among the large, medium and small tier banks in Kenya, there has been no study on the factors considered by such banks in choosing external auditors despite such auditors being dearer than their counterparts.

There has been scanty research specifically on determinants of choice of external auditors more so in developing countries. Past studies have been carried out in developed countries. Past studies are also not conclusive such as Higgins and Ferguson (1991) study which was narrow in scope focusing on reliability, responsiveness, assurance and empathy. Therefore, it failed to include other service quality considerations. Bojanic (1991) study as well as that of George and Solomon (1980) focused on considerations made in criteria used by organizations in selection of general accounting services without any mention of audit services.

There is conflicting evidence on whether audit fee is a consideration in selection of external auditors. For instance whereas Crane (1989) and Segal (1991) found out that audit fee was not an important consideration, George and Solomon (1980) concluded that it was actually a key consideration. Contradictory research also exists on whether leverage is a consideration in selection of an external auditor with Broye and Weill (2008) finding out that leverage was a criterion in the auditor selection, a view not supported by other researchers such as O'Keefe et al (1994) who argue that ownership status of an organization stands out as the main factor influencing choice of auditors. They argue that listed companies have an incentive to hire Big Four audit firms with the intention of having correct financial statements. In addition, there also lacks conclusive research on whether size of an organization impacts on auditor choice. For instance, Hay and Davis (2004) and Knechel et al (2008) found out that as companies grow in size, their operations become complex therefore requiring more experienced auditor and thus big companies in terms of asset base are likely to hire Big Four firms.

Arens and Loebbecke (1976) however found no relationship between size of an organisation and complexity of its operations arguing that auditors tend to gain an understanding of the operations of a client based on the length of period such a client is served. They could however not relate size of an audit firm with knowledge of a client's operations. This study therefore sought to bridge this study gap by evaluating the determinants of choice of external auditors in commercial banks in Kenya.

1.3 Research Objectives

The main objective of this study was to determine the factors that influence choice of external auditors by commercial banks in Kenya. The study mainly focused on the following specific objectives.

i. Effect of audit fees in selection of external auditors
ii. Relationship between asset base of a bank and selection of an auditor
iii. Whether the bank is listed in the Nairobi Securities Exchange or not

1.4 Value of the Study

It is expected the study will be of benefit to the following;

a) Management of banking institutions

Management of banking institutions and audit committee members who are usually in charge of engaging external auditors will get valuable information regarding factors to consider when hiring external auditors.

b) External auditors

The study will provide external auditors with useful information regarding service delivery and on the needs of banking institutions. Further, it will offer small and medium audit firms tips on how they could improve their services so as to access the clientele served by big audit firms.

c) Academicians

The study will contribute to the body of knowledge and hence will be of interest to both researchers and academicians who seek to explore the determinants of choice of external audit firms in commercial banks.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

The purpose of this chapter is to present a review of literature relating to the determinants of choice of audit firms. The chapter has two sections that is, the theoretical framework and secondly, empirical evidence of studies done in this area. Although external auditors play an important role in improvement of corporate governance, their selection has not attracted much attention from scholars since corporate finance literature has traditionally focused on the study of importance of external auditors in monitoring agency problem, value of external audits or benefits of having an effective internal audit function.

2.2 Theoretical Framework

Since a number of previous studies on the subject area that is the determinants of choice of external auditors, a number of approaches have been used to undertake research on this area.

The following is a review of the theoretical framework of factors influencing choice of external auditors.

2.2.1. Theories Supporting the Study

2.2.1.1 Agency Theory

Choice of external auditors could be explained by the agency theory where following separation of ownership and control, there arises agency problems and an external auditor is appointment by independent parties as a mediator in reduction of agency problems.

CBK (2006) provides that external auditors should be recommended for appointment by an audit committee which should comprise of non-executive Board members. However, so as to comply with the Companies Act, appointment of an external auditor should be approved or ratified by shareholders in an annual general meeting or extraordinary general meeting. The recommendation should therefore stem from the audit committee to the full Board and then for approval by the shareholders. Reduction of agency problem through monitoring mechanisms such as hiring external auditors should be controlled to ensure that costs arising thereof do not exceed benefits accrued.

2.2.1.2 Stakeholder Theory

The stakeholder theory as noted by Broye and Weill (2008) argue that an organization is owned by a number of parties and thus the previous assumption by the theory of the firm that a company solely belongs to shareholders is misleading. As the number of stakeholders such as lenders, employees, regulators and shareholders increase, complexity of relationships within organization also increases. Thus, Al-Bawab (2012) observes that choice of external auditors should consider fees charged size of the company, capital structure as well as ownership structure. The following is a review of related literature on each of these factors and how they influence choice of external auditors.

2.2.2 Impact of Audit Fees in Selection of External Auditors

Hayward (2007) argues that audit fees form one of the significant considerations when choosing an external audit firm. He observes that banks are currently facing intense pressure to reduce their cost of operation owing to the heightened competition and declining margins. Efforts are therefore made to hire cost efficient auditors. El Ghoul et al (2007) support this view noting that banks tend to evaluate the marginal cost of engaging a Big Four audit firm in relation to extra value derived in terms of reputation and quality of audit. Therefore, potential advantages and disadvantages that could be gained from a potential audit firm are assessed before making the choice. Nikkinen and Sahlstrom (2004) observe that audit fees are usually determined by the perceived business risk from the auditor's perspective, audit complexity and weaknesses in internal control. However, Khurana and Raman (2004) noted that Big Four audit firms charge relatively higher fees than small firms.

The research by Thornton and Moore (1993) investigated how audit fees are determined and what their influences are on the auditor choice. Simunic (1980) focused on three of the four generally suggested audit fee determinants, namely, weakness of internal control, business risk and audit complexity. One of their main findings is that: "The marginal cost of auditor quality varies inversely with the companies' internal control strength." (Thornton and Moore, 1993, p. 346). Other studies such as Simunic (1980) and Francis and Simon (1987) focused across different international settings and investigated whether there is a relation between Big Four auditors and higher audit fees charged. Although previously there was many inconsistent evidence for this relation, Choi et al (2008) discovered that the fees charged by Big Four auditors were higher in the 13 countries they investigated than the fees charged by non-Big four auditors. In addition to this primary finding and in contrast, they found that the premiums are positively related to the strictness of the legal regime. Therefore, following Choi et al. (2008) and Francis and Wang (2008) a conclusion can be made that the auditor fees are, in the strict legal regimes, an indication for the higher quality a Big Four auditor offers compared to the non-Big Four auditors.

Klein and Leffler (1981) also found evidence that brand-name reputation generates quasi-rents and stimulates audit companies to develop and maintain brand-name reputation. Accordingly they suggested that quality is also determined by reputation. In addition, Simunic and Stein (1996) found evidence that Big Four firms have high brand-name reputations. Auditors with a certain reputation are assumed to have fewer incentives to decrease their quality because of the quasi-rents they are able to generate with their reputation and their brand-name. The study of Moizer (1997) investigating auditor reputation revealed that company managers experience a Big Four auditor as different from others. They are expected to provide higher quality services in accordance with their other peers. A third determinant for being a high-quality auditor is therefore brand-name reputation. Due to these characteristics and determinants of auditor-quality investigated and proven to be applicable, most researchers define Big Four auditors as high-quality auditors.

Thornton and Moore (1993) noted that audit fee is one of the determinants of choice of audit firms. Hayward (2007) observes that whereas audit fees have been rising over the years, companies are seeking to reduce their cost of operation owing to constricting markets following the recent economic downturn. Therefore before engaging external auditors, companies are expected to consider the amount of fees charged. However, in the case of Kenyan Banks, this might not be the case since a majority is audited by Big Four audit firms whose fees are usually high.

2.2.3 Effect of Size of an Organization and Choice of an Auditor

When starting the investigation for the most important determinants of the auditor choice, one first has to consider the potential internally-driven determinants. In the literature, the choice of a particular auditor is partially seen as a measure taken by a company's management to reduce the agency problems that occur within the company itself. Therefore it is important if one takes into account internal agency problems and their related costs.

The general assumption in the literature is that agency problems increase in tandem with the growth in size and complexity of an organisation that requires to be audited. Therefore another general assumption is that the likelihood of hiring a high-quality auditor will increase when the complexity and the size of the company that needs to make the auditor choice becomes bigger. Chow (1982) made a cost benefit-analysis of monitoring contracts performed by external auditing. He assumed that the total amount of potential wealth transfer increased with firm size for a given manager ownership share and debt/equity ratio. His study pointed out the benefits of undertaking monitoring though this increased with growth in size of an organization. However, Arens and Loebbecke (1976) found out that costs of establishing a monitoring system are mainly fixed as external auditors face three major start-up costs when performing their first audit, even for small firms they have to verify the details of the balance sheet that are of permanent nature and the beginning balances. They also have to become familiar with the client's operations.

There are other views that the marginal cost of maintaining a monitoring system will decrease as size increases, due to the fact that variable costs are not proportionally increasing with firm's size. Abdel-khalik (1989) provided another argument and found evidence that it becomes more difficult for owners of private companies to oversee the enterprise when firm size increases. As the length of the chain of control increases, delegation becomes necessary. Authority is then delegated down the chain, resulting in a lack of observability between existing hierarchies and less effective communication. This causes a higher risk for moral hazard problems and opportunism. Internal control cannot always compensate this loss of control (Abdel-khalik, 1989), that is why companies demand monitoring systems in the form of external audits in order to enhance the owners' confidence in reducing the moral hazard risk. They state that the size of tangible assets (total assets) employed by an organization can be considered as the maximum amount of wealth at risk. This also confirms the need for external auditing as firm size increases as well as the need for high-quality monitoring. Simunic and Stein (1987); Abdel-khalik (1989); Hay and Davis (2004) and Knechel et al. (2008) are other researchers that have found evidence for the relation of the auditor choice and the complexity of the company.

In accordance with Knechel et al. (2008) the likelihood of hiring a Big Four auditor is positively related to the internal complexity of the company. In accordance with Knechel et al. (2008), size of the company is assessed in terms of a company's asset base. They suggested that there is a relation between the size of a company in terms of asset base and its complexity, consistent with Stice (1991) and Hay and Davis (2004). Knechel et al (2008) also found out that asset base is a proxy for the increase of internal complexity and the related agency costs. Due to this size is considered to be positively associated with the hiring of a high-quality auditor. This study evaluated whether asset base of a commercial bank was a significant determinant of choice of an auditor.

2.2.4 Effect of Ownership Structure on Selection of External Auditors

From an agency perspective (Nikkinen et al, 2004) need for external audit arises from separation of ownership and control which gives rise to agency problem. Consequently "recent research highlights the incentives for controlling shareholders to develop effective corporate governance mechanisms to reduce the potential problems from hiring professional managers." (El Ghoul et al 2007, p. 5). Engaging a high-quality auditor is suggested by their research to be such an effective control mechanism because of the greater transparency in financial statements it offers.

El Ghoul et al (2007) in addition to Fan and Wong (2005) investigated whether the superior external monitoring brought by Big Four auditors helps reduce the agency problems that stem from concentrated ownership. Consistent with controlling owners having an incentive to maximize the level of their firm value, El Ghoul et al (2007) found evidence that there is a negative relation between the level of ownership rights of the controlling shareholders and the demand for a Big Four auditor. In addition, when the ownership structure consists of multiple shareholders, El Ghoul et al (2007) found a decrease in the demand of high-quality auditors. Consistent with Laeven and Levine (2005) suggesting that when multiple controlling owners are present, the internal monitoring is stronger, and therefore, according to Thornton and Moore (1993) the incentives to hire a Big Four auditor are lower. A final feature of ownership structure investigated by El Ghoul et al. (2007) was the impact of the identity of the controlling shareholder. As the majority of continental European companies are under family control, El. Ghoul et al (2007) hypothesized that the quality of reporting would not increase in the presence of a Big Four auditor as family owners want to reflect the firms' true performance. In accordance with their hypothesis, they found evidence that when a company is family controlled, this latter will lower the incentive to hiring a Big Four auditor in these companies. Next to these three ownership based variables determining the auditor choice, Beasley and Petroni (2001) found that the number of independent, outside members in the board of directors has a positive influence on the selection of a Big Four auditor. According to Fama (1980) boards of directors are used as a mechanism to control the conflict between the owners and the managers as they perform a monitoring role. In their research, Beasley and Petroni (2001) provided evidence that independent, outside directors will be more eager than inside directors to provide the stakeholders with qualitative and correct information, therefore increasing the quality of their monitoring role. In earlier research Beasley (1996) had already provided evidence that outside directors have a positive influence on the reduction of management fraud, confirming the earlier assumptions. In conclusion, where there is separation of ownership and control more so in listed banks, it is expected that such banks are likely to engage Big Four audit firms with a bid to reducing agency problems. However, where ownership is closely held by a few shareholders, there will be no need to hire Big Four audit firms.

2.3 Empirical Evidence

Professional services can be described in terms of characteristics or features that they possess. While many of these features of the service are endemic to the client, the choice criteria are those attributes that are important to the client in measuring or assessing the offerings (Crane 1989).

There has been a limited number of studies regarding the identification of choice criteria in the selection process of professional accounting services: Higgins and Ferguson (1991); Bojanic (1991); George and Solomon (1980). Several studies have focused on a single professional service criteria such as Segal (1991) focusing on price. Further studies have indirectly addressed choice criteria in relation to professional services for instance Crane (1989) identified five choice criteria in relation to lawyer selection while Al-Bawab (2012) focused on choice criteria though reviewing the perceptions of auditors rather than those of management of banking institutions.

However, there are shortcomings in the previous research. Firstly, studies by Higgins and Ferguson (1991) focused narrowly on dimensions of service quality (tangibles, reliability, responsiveness, assurance, empathy) and did not acknowledge that there may be other choice criteria important in the selection of professional services outside of these dimensions. Additionally, the use of service quality as an evaluative criterion infers that consumers have had some experience with the service.

The second shortcoming is that Higgins and Ferguson (1991); Bojanic (1991) and George and Solomon (1980) identified choice criteria used by clients in selecting general accounting services and not for the selection of an auditing service. With the exception of George and Solomon (1980), these studies have not examined organizational choice criteria. Thirdly, many of the studies cited previously, only address the influence of one criterion and do not focus their empirical research on specific professional accounting services. That is, the criteria identified may not be applicable to the choice of all other professional services. It therefore appears there is a need to concentrate research efforts in the direction of developing a comprehensive set of criteria used by publicly listed corporate clients to select the external auditing service offered by accounting firms.

Drawing from previously cited studies the determinants of choice of external auditors will be selected for testing in this study. The development of the underlying dimensions of each criterion has resulted from extensive analysis of literature, the researchers' knowledge and experience in the auditing field and a number of experience interviews with members of the accounting profession and industry. These criteria tend to encompass most of the dimensions that companies take into consideration when selecting their audit firm.

The underlying dimensions for fees criterion are the fee structure and the method of pricing services, for example, hourly charge-out rate or tendering of fixed fees. There are inconsistencies in the prior studies' findings as to the importance of this criterion. Studies have indicated that price/fee structure is an important criterion (Segal 1991) whereas Crane (1989) supported the view that price/fee was not as an important criterion. The findings from George and Solomon (1980, p.81) indicated that although more than fifty percent (56%) considered fee estimates had some influence upon the selection process, only a small proportion (15%) stated this criterion has been highly influential in their selection.

Broye and Weill, 2008), using different definitions of leverage, have investigated the impact of leverage on the choice of an auditor. Although the relation generally is hypothesized to be positive, the results however have been inconclusive. Their research a clearer view that the use of leverage is a criterion in the auditor selection process. In their study, they investigated this relation in 10 European countries and found evidence that the variation of the criterion leverage is related to the different levels of auditor liability exposure.

Broye and Weill (2008) suggested that the likelihood of having a Big Four auditor increases. They argued that it is likely that companies, listed on a stock exchange choose Big Four auditors as they are more experienced in complex operations. Furthermore, Big Four auditors have a large international network at their disposal and have the ability to signal private information on the market.

However, they did not find empirical support for any specific country and their study mainly focused on developed markets. This can be explained through the limited fraction of listed companies in their sample. O'Keefe et al (1994) argued in their study of auditor services that: "Managers of public firms are generally viewed as having greater incentives to overstate financial positions and results of operations to maximize their compensation and maintain their employment." (O'Keefe etal 1994, p. 249). This latter supports the views that listed companies have the incentive to hire Big Four auditors to signal their intention to provide correct financial statements.

In order for accounting firms to be effectively positioned, there is a need to understand the specifics of which criteria are important to publicly listed companies when selecting a new external auditor. It is believed that the above mentioned criteria will encompass most of the dimensions that companies take into consideration when selecting or reappointing an auditor. They will be tested in this study to understand the determinants of choice of external audits in commercial banks in Kenya.

2.3.1 Empirical Evidence from Kenya

The present study represents an attempt to contribute to the body of knowledge in the area of external choice criteria in Kenya. The empirical research undertaken has broken new ground as no previous research on this topic has been performed in Kenya. Previous studies have mainly focused on the effectiveness of internal audit function such as Rutto (2011). He found out that internal audit function is very useful in improving corporate governance. For internal audit function to be effective, Rutto (2011) noted that the function should be independent of management for instance by reporting to the audit committee. This study however did not consider the role played by external auditors where an organization has an effective internal audit function. Kupakuwana (2011) upheld the importance of putting in place effective internal control systems in creation of a sustainable retail banking and asset management. The study was however not focused on the Kenyan banking industry and did not identify specific factors considered in selection of external auditors.

Sigowo (2009) and Kibet (2008) studied the roles performed by internal auditors in promotion of good corporate governance. Whereas the researchers studied the importance of corporate governance in reducing agency problems in an organisation, the role played by external auditors was conveniently overlooked. Chepkorir (2010) studied the roles and challenges of internal auditing in the Kenyan banking industry. She noted that internal auditors are very effective in promotion of corporate governance practice among Kenyan banks. Her study however did not consider the role of external auditors and neither did it consider the selection criteria made. The study of factors considers in selection of external auditors despite attracting numerous research in developed countries has not gained any notable attention by researchers in Kenya. The study therefore seeks to bridge this gap by finding out the determinants of choice of external auditor by Kenyan commercial banks. It is motivated by the need to understand why most commercial banks in Kenya prefer to be audited by the Big Four audit firms.

2.4 Summary

Commercial banks in Kenya are mainly audited by Big Four audit firms. This is against the backdrop of the high audit fees usually charged by such firms relative to their peers. Whereas a number of studies have been done in developed countries, this study breaks ground for this subject area. Research in Kenya has in the past focused on effectiveness of internal audit function and audit committees with no specific focus on factors that should be considered by a bank in selection of external auditors. The study is expected to provide useful hindsight in the subject area and is hoped to provoke further research focusing on commercial banks.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter deals with, the research design, population, sample, data collection and data analysis, which describes the firms and variables, included in the study and applied statistical techniques in investigating the determinants of choice of external auditors in commercial banks in Kenya.

3.2 Research Design

The research design employed in this study is descriptive in nature. Descriptive studies describe characteristics associated with the subject population. Saunders et al (2003) assert that a descriptive research portrays an accurate profile of persons, events or situations. Descriptive research collects data from members of a population and helps the researcher get the descriptive existing phenomena by asking individuals about their perceptions, attitudes, behaviour or values. Moreover, it explores the existing status of two or more variables at a given position in time and whether a relationship exists between them; hence most suited in establishing the determinants of choice of external auditors in commercial banks in Kenya.

3.3 Population

According to Cooper and Schindler (2000), a population is the total collection of elements about which we wish to make inferences. The target population in the study was 44 commercial banks in Kenya for the year ended 31 December 2011 (see appendix 1).

3.4 Sample

Data was drawn from the financial statements of 44 registered commercial banks in Kenya for the year ended 31 December 2011. The period was chosen since it was the most latest financial period for which banks had prepared audited accounts as at the time of the study. Audited financial statements were preferred in this study since they are more credible than unaudited financial reports.

3.5 Data Collection

The study made use secondary data obtained from the financial statements of the 44 Kenyan commercial banks for the year ended 31 December 2011. Audited financial statements were used in the study since they are credible source of financial and non-financial information and are also freely available. Asset base for each bank was noted using the amounts disclosed in financial statements. The researcher also considered the amount of audit fees as disclosed in financial statements as well as whether the bank was listed in the NSE from other information disclosed in financial statements.

3.6 Data Analysis

First, data collected was cleaned, sorted and collated. Then, it was analyzed with the help of Statistical package for social scientists (SPSS version 17). Descriptive statistics such as mean, maximum and minimum were computed and tabulated using frequency distribution tables. In order to test the relationship between the variables the inferential tests including the Pearson Product-Moment Correlation Coefficient and regression analysis was used. First, Pearson Product-Moment Correlation Coefficient as measures of association was used to examine the relationship between the independent and dependent variables. The relations were explored with the use of Pearson's correlation coefficient. Pearson's correlation coefficient calculates a relationship between two variables. Correlation co-efficient is a measure of the strength of linear association between two variables. Correlation ranges between -1.0 and +1.0. If the correlation is positive, a positive relationship is inferred. If it is negative, the relationship is negative.

Second, regression analysis was used to analyze the relationship between auditor choice and other factors such as audit fees, size of banks in terms of asset base and whether the bank was listed. The regression model that was evaluated is represented as follows:

BIG4 = P CSi + pOSi + P ABi + e.................................*equation 1*

Equation 1 defines the regression equation used in this study where:

Where;

BiG4= Choice of auditors was given a dummy variable of either 2 or 1 depending on whether it's a big 4 or another audit firm. If a Big Four audit firm was used, a dummy variable of 1 was given and a variable of 2 if otherwise.

P = Coefficient of regression,

CSi = Audit fees

OS = whether a firm is listed or not. A dummy variable of 3 was used for listed banks and 4 if otherwise.

AB = Asset base

8 = the error term

i=l, 2........, 44 banks.

The slope of the coefficients is represented by (3 whose sign will depict the relationship between choice of audit firms and various factors.

The significance of the relationship between the variables in the model was tested using F-Statistic at a significance level of 0.05. A P-Value of less than 0.05 was indicative of existence of a significant relationship between the variables in the model and a P-Value of more than 0.05 was indicative of lack of evidence of significant relationship between the variables.

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CHAPTER FOUR

DATA ANALYSIS, RESULTS AND DISCUSSION

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4.1 Data analysis & findings

4.1.1 Introduction

The study collected and used secondary data. It was the intention of the researcher to collect data for all the 44 commercial banks in Kenya for the year ended 31 December 2011. However, one of the banks was not operational during the period and thus the final data used was from 43 commercial banks. Appendix I shows a list of all commercial banks in Kenya whereas appendix II shows the results of the banks studied in form of audit fees, whether listed, total assets, and whether a Big4 auditor was used. The variables in the study were as follows. First, choice of an auditor whether Big 4 or not (dependent variable) was determined by four variables: audit fees, listing, and total assets. Data for these variables was available for the period under study for all the 43 banks and are therefore reported in this study.

Thirdly, audit fees charged in millions Kenya Shillings was analyzed for all the 43 banks so as to determine whether this is a consideration in choice of an external audit firm as asserted by Hayward (2007). An evaluation was also made on whether there was a relationship between the choice of an auditor and audit fees. The size of the bank in terms of total assets was also analyzed and a correlation between asset base and choice of an external auditor analyzed.

Two control variables were introduced into the model in line with previous studies. These were whether the bank was listed or not and whether a Big4 auditor was used or not. For banks using a Big4 auditor, a dummy variable of 1 was used whereas those that did not use a Big4 audit firm were assigned a dummy variable of 2. Listed banks were given a dummy variable of 3 whereas unquoted ones were given a dummy variable of 4. Choice of an external auditor either Big 4 firm or not, was the dependent variable for this study whereas audit fees, ownership structure, and asset base taken as independent variables. Correlation analysis was done to assess the relationship between these variables.

This chapter presents the results of the study. The chapter is organized as follows. First, the descriptive results are shown in section 4.1. Section 4.2 provides the results on OLS regression assumption tests while section 4.3 provides the results of regression analysis.

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4.1.2 Descriptive analysis

The descriptive results are shown in table 1. The results show that audit fees ranged from a minimum of Kshs 1.2 million to a maximum of KShs 18 million. The mean audit fees charged to KShs 4.8 million with a standard deviation of KShs 3.57 million. The minimum total assets were KShs 2.07 billion whereas the maximum asset base was KShs 282 billion. Mean asset base for banks was KShs 47.9 billion with a standard deviation of KShs 62.7 billion.

Two dummy variables were used, choice of external auditors and whether the bank was listed. From the analysis of choice of external auditors, the mean score was 1.14 with a standard deviation of 0.347. As such, most commercial banks were audited by a Big 4 auditor.

Ownership structure in terms of listing showed that a majority of the banks were not listed with a mean score of 3.77 and a standard deviation of 0.424. Very few commercial banks had been listed in the NSE as at 31 December 2011.

Table 1: Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
Continuous variables					
Audit fees (KShs Million)	43	1.2	18.0	4.800	3.5665
Total Assets (KShs Million)	43	2070	282494	47913.49	62670.133
Valid N (listwise)(listed/non	43				
Dummy variables					
Big 4 Auditor or not	44	1	2	1.14	.347
Listed or not	44	3	4	3.77	.424

4.1.3 Testing Assumptions for Multiple Regression

In order to run a multiple regression analysis, Cooper and Schindler (2000) advise that a number of assumptions for the same should be checked. These assumptions include; test for normality, non-multicollinearity, homoscedasticity of variance, independence of errors, and outliers. These tests are carried out as follows.

Normality of Distribution

Normality of distribution is usually tested using either Kolmogorov-Smirnov or Shapiro-Wilk test. Cooper and Schindler (2000) observe that Shapiro-Wilk test is suitable for a sample of 50 or less. As such, the test is used to test normality of distribution in this study. The test evaluates the hypothesis that the distribution is not normal and therefore a significant value should lead to acceptance of the hypothesis.

As shown in table 2, the results showed that the variables were significant at 5 percent level. This therefore leads to the acceptance of the null hypothesis that the data is not normally distributed. The data must therefore be transformed for regression.

Table 2: Tests of Normality

/	Kolmogorov-Smirnov[3]			Shapiro-Wilk		
	Statistic	df	Sig.	Statistic	df	Sig.
Big Four Auditor	.515	43	.000	.412	43	.000
Audit fees (KShs Million)	.195	43	.000	.803	43	.000
Listed or not	.474	43	.000	.524	43	.000
Total Assets (Kshs Million)	.256	43	.000	.717	43	.000

a. Lilliefors Significance Correction

Non-multicolinearity

Non-multicollinearity is tested using correlation analysis as shown in table 3. A tolerance of less than 0.20 is considered as an indicator of multicollinearity of independent variables. Based on the results of analysis, no variable had a tolerance of less than 0.20 and hence there was no multicollinearity of variables.

Table 3: Tests for multicolinearity

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
	B	Std. Error	Beta			Tolerance	VIF
(Constant)	1.863	.890		2.093	.043		
Audit fees (KShs Million)	-.027	.021	-.271	-1.267	.213	.473	2.116
Listed or not	.043	.198	.053	.220	.827	.371	2.693
Total Assets (Kshs Million)	2.704E-7	.000	.048	.191	.849	.339	2.952

a. Dependent Variable: Big Four Auditor

Homoscedasticity

Homoscedasticity of variance refers to residuals at each level of the independent variable being similar. This was tested using Levene's test and since the Levene's test was insignificant at ($P<0.05$) for all of the variables, then the assumption of homogeneity of variance between the groups is rejected. Cooper and Schindler (2000) observes that homoscedasticity of variance is related to the assumption of normality. As such, the assumption of normality is not met, the assumption of homoscedasticity was not met either. The data must therefore be transformed for regression.

Table 4: Test of Homogeneity of Variances

	Levene Statistic	df1	df2	Sig.
Audit fees (KShs Million)	6.142	1	41	.017
Listed or not	19.798	1	42	.000
Total Assets (Kshs Million)	6.189	1	41	.017

Serial Autocorrelation

The independent of errors also referred to as autocorrelation is usually tested using the Durbin Watson test. The test statistic varies between 0 and 4, and a value of 2 indicates no auto correlation of errors. The Durbin-Watson statistic was 1.409 and thus serial autocorrelation of errors did not occur since the test value was not close to 2.

Table 5: Test for serial autocorrelation

Model	R	R Square	Adjusted R Square	Std. Error of Estimate	Durbin-Watson
1	.423[a]	.179	.093	.334	1.409

a. Predictors: (Constant), Total Assets (Kshs Million), Audit fees (KShs Million), Listed or not

b. Dependent Variable: Big Four Auditor

Outliers

Outliers are the values that can have a remarkable influence on the correlation coefficient particularly in small samples because they are significantly lower or higher than other values in the data set (Cooper and Schindler, 2000). The standard deviations of residual statistics were 0.951 which shows that there were no outliers in the sample. Cooper and

Schindler (2000) observe that having residual statistics higher than 3 is an indication of existence of outliers.

Table 6: Residuals Statistics

	Minimum	Maximum	Mean	Std. Deviation	N
Predicted Value	.80	1.76	1.14	.148	43
Residual	-.333	.870	.000	.318	43
Std. Predicted Value	-2.292	4.212	.000	1.000	43
Std. Residual	-.997	2.606	.000	.951	43

a. Dependent Variable: Big Four Auditor

Transformation of data

A number of assumptions of multiple regressions were not met and thus the need to transform the data through ranks and then using Ordinary Least Squares (OLS) on the transformed data. Data was transformed into normal scores and tank scores. Transformation of data was done using Van der Waerden's formula and then the ranked data subjected to OLS regression analysis.

4.2 Summary of findings and interpretation

The following is a summary of findings of the study based on regression and correlation analysis for both full rank and normal scores.

Table 7: Full Rank Correlation Analysis

Before the rank results are shown, table 7 below presents the correlation results for the independent variable and dependent variables. These initial results can reveal that there is a significant relationship between audit fees and listing structure, total assets and choice of audit firm. Listing structure of a company was also related to level of audit fees charged and total assets. In addition, total assets were also related to listing structure of a company. Choice of a Big Four auditor had a significant relationship with audit fees charged.

		R. of Big4	R. of Fees	R. of Listed	R. of Assets
R. of Big4	Pearson Correlation	1	-.501"	.215	-.222
	Sig. (2-tailed)		.001	.160	.153
	N	44	43	44	43
R. of Fees	Pearson Correlation	-.501"	1	-.588"	.679"
	Sig. (2-tailed)	.001		.000	.000
	N	43	43	43	43
R. of Listed	Pearson Correlation	.215	-.588"	1	-.661"
	Sig. (2-tailed)	.160	.000		.000
	N	44	43	44	43
R. of Assets	Pearson Correlation	-.222	.679"	-.661"	1
	Sig. (2-tailed)	.153	.000	.000	
	N	43	43	43	43

From the table 7 above, correlation of Rank of Big 4 with Fees was significant at 1 percent meaning that there is a significant relationship between choice of audit firm and the level of audit fees charged. There was also a significant relationship between Rank of Fees and Rank of Listed and Rank of Assets thus indicating that whether a bank is listed had a significant relationship with audit fees and its asset base.

Full Rank Score OLS Regression Analysis

From table 8 below, the ranked score regression of Big 4 auditors explained 20.1 percent, measured by adjusted R2 with an F Ratio of 3.636 which was significant at 5 percent, the regression model accounted for 27.7 percent of the variance in choice of auditors.

Table 8: Model Summary for Full Rank Regression Analysis

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics				
					R Square Change	F Change	df1	df2	Sig. F Change
1	.526[a]	.277	.201	6.895994	.277	3.636	4	38	.013

a. Predictors: (Constant), Rank of Assets, Rank of Fees, Rank of Listed

Table 9 below provides results of Full Rank OLS regression of the rank of choice of external auditors as the dependent variable and ranks of assets, fees and listing structure as the predictor variables. Based on the OLS Regression Analysis at 95 percent confidence level, level of audit fees charged was not a significant of choice of external audit firm for commercial banks in Kenya. However, listing structure and asset base were significant determinants of choice of external auditors.

Table 9: Full Rank Regression analysis

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.	95.0% Confidence Interval for B	
	₩ B	Std. Error	Beta			Lower Bound	Upper Bound
1 (Constant)	29.216	5.935		4.923	.000	17.202	41.231
Rank of Fees	-.404	.120	-.657	-3.377	.002	-.646	-.162
Rank of Listed	-.024	.169	-.029	-.142	.888	-.366	.318
Rank of Assets	.126	.146	.205	.861	.395	-.170	.421

a. Dependent Variable: Rank of Big4

Normal score OLS Regression Analysis

From table 10 below, the normal score regression of Big 4 auditors explained 25.4 percent, measured by adjusted R2 with an F Ratio of 4.567 which was significant at 5 percent, the regression model accounted for 32.5 percent of the variance in choice of auditors.

Table 10: Model Summary for Normal OLS Regression Analysis

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics				
					R Square Change	F Change	dfl	df2	Sig. F Change
1	.570"	.325	.254	.4973642	.325	4.567	4	38	.004

a. Predictors: (Constant), Normal Score of Assets using Blom's Formula, Normal Score of Fees using Blom's Formula, Normal Score of Listed using Blom's Formula

Based on the normal score OLS Regression Analysis using Blom's formula as presented by Table 11 below, at 95 percent confidence level, listing of a bank, and asset base were significant determinants of choice of external auditors. Level of audit fees was however not a significant predictor variable for external auditors' choice.

Table 11: Normal Score Regression Analysis

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	95.0% Confidence Interval for B	
		B	Std. Error	Beta			Lower Bound	Upper Bound
1	(Constant)	.056	.077		.732	.469	-.099	.211
	Normal Score of Fees	-.435	.115	-.738	-3.783	.001	-.668	-.202
	Normal Score of Listed	-.046	.183	-.051	-.251	.803	-.416	.325
	Normal Score of Assets	.153	.141	.260	1.080	.287	-.133	.439

a. Dependent Variable: Normal Score of Big4 using Blom's Formula

CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter presents the summary and discussion of findings in section 5.2, conclusion of the study in section 5.3, recommendations for policy and practice in section 5.4, limitations of the study in section 5.4, limitations of the study in section 5.5 and suggestions for further research in section 5.6.

5.2 Summary of Findings and Discussion

The study intended to determine the determinants of choice of external auditors. Complete sample of 44 commercial banks in Kenya was used to carry out the analysis. Since a multiple regression analysis was to be carried out, conditions for the same were rested before data was transformed using rank and normal scores and the regression run on the transformed on the transformed data.

The results from the correlation analysis showed that choice of external auditor was not significantly affected by the level of audit fees contrasting findings of the studies by Hayward (2007) and El Ghoul et al (2007) whose findings indicated that companies are usually mindful of audit fees when selecting potential external auditors. This however confirmed findings of studies by George and Solomon (1980) and Thornton and Moore (1993) that audit fees is not an influential criterion for choice of external auditors. However, this study was different from that of George and Solomon whose main focus was the choice criterion for selection of general accounting services and not external auditing services as studied in this research.

However, similar to the findings of Choi et al (2008) a strong positive relationship between level of external audit fees and choice of a Big Four auditor was noted. This was also in agreement with the findings of Klein and Leffler (1981) who observed that Big 4 audit firms have built a reputation of quality and capitalise on the same to charge premium audit fees. It is important to note however, that unlike Klein and Leffler which mainly relied on responses from management regarding consideration of external auditors, this study considered external auditors already hired by banks in their latest audited financial statements.

The regression models explained between 27.7 percent and 32.5 percent and based on their F ratios, audit fees was not a significant predictor variable. Listing structure and asset base were however significant determinants of choice of external auditors. Knechel et al (2008) found out that big companies, as denoted by their asset base, are characterized by complex structure and thus need for highly qualified external auditors such as Big4 auditors. The study is also consistent with Knechel et al (2008) findings that big companies in terms of asset base are in need of equally big auditors so as to take care of operations which could be located in different regions. The relationship between asset base and choice of an external auditor as found out by Simunic and Stein (1987) was therefore confirmed by this study. The study was also consistent to O'Keefe etal (1994) findings that listed companies have a higher incentive to hire Big Four auditors. This study however adopted a focus on commercial banks rather than listed companies as was the case in O'Keefe etal (1994) study.

5.3 Conclusion

The study reaches a conclusion that choice of external auditors is unaffected by eternal audit fees charged. Thus external audit fees have not had a significant influence on the choice of external auditors for commercial banks in Kenya. In addition, asset base of a bank does not have a significant influence on the choice external auditors with both big and small tier banks opting for Big Four audit firms. The study also concludes that listing status of a bank was not a significant determinant of choice of external auditors. Agency problem often increases with separation of ownership and control through public listing. A strong relationship between choice of auditors and audit fees charged was confirmed by this study indicating that Big Four auditors were expensive.

5.4 Recommendations

The study makes a number of recommendations. Theoretically, level of external audit fees is a significant consideration in determination of choice of external auditors. From this study however, external audit fees was not a significant determinant choice of external auditors and hence audit firms should not be overly concerned about the audit fees quoted in their bids for audit services in commercial banks in Kenya. They should however ensure that quality services are offered to reduce agency problems in banks. It is important for management of banking institutions to note the relationship between choice of external auditors and level of audit fees charged. Big Four audit firms tend to charge premium audit fees and thus where small audit firms have similar capacity to that of Big Four audit firms; it would be cost effective to engage a small firm, thus unless the high audit fees charged by Big Four audit firms can be justified through high quality, it would be unnecessary to hire such firms.

5.5 Limitations of the Study

The study faced a number of limitations. The first limitation is in the explanatory power of the model. The model explained between 27.7 percent and 32.5 percent of the variance. This suggests that there are a number of variables that were left out of the model which would improve the explanatory power of the model. Secondly, the data on choice of external auditors was based on audited accounts as at 31 December 2011 and thus a consideration of changes that could have been made on the choice of external auditors as well as the review of auditors in the past was not evaluated.

5.6 Suggestions for Further Research

This is need for more research on this area in order to provide significant determinants of choice of external auditors in commercial banks in Kenya. This should be done by using more independent variables in the model so as to improve the explanatory power of the model. Further studies should also be carried out by evaluating changes in external auditors such as from Big Four firms to small firms and vice versa and a correlation between such with changes in predictor variables such as asset base, audit fees and listing structure. This would help to assess whether changes in these variables has an impact on choice of external auditors.

There is also need to carry out industry-wide studies or case studies on the same in order to get an in-depth analysis of this phenomenon for various industries or specific companies. For instance, a similar study could be done for registered insurance companies in Kenya as well as mutual funds and pension schemes among others.

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APPENDIX

I. List of commercial banks in Kenya

	Bank	Auditor	Big 4 (Y/N)	CBK Class
1	Cooperative Bank of Kenya	Ernst & Young	Y	Large
2	Equity Bank	Ernst & Young	Y	Large
3	Kenya Commercial Bank	KPMG	Y	Large
4	Standard Chartered Kenya	KPMG	Y	Large
5	Barclays Bank	PWC	Y	Large
6	CFC Stanbic Bank	PWC	Y	Large
7	Chase Bank (Kenya)	Delloite	Y	Medium
8	Family Bank	Delloite	Y	Medium
9	NIC Bank	Delloite	Y	Medium
10	Prime Bank (Kenya)	Ernst & Young	Y	Medium
11	Citibank	KPMG	Y	Medium
12	I&M Bank	KPMG	Y	Medium
13	Housing Finance Co. Of Kenya Ltd	KPMG	Y	Medium
14	Bank of Africa	PWC	Y	Medium
15	Commercial Bank of Africa	PWC	Y	Medium
16	Diamond Trust Bank	PWC	Y	Medium
17	Ecobank Kenya Limited	PWC	Y	Medium
18	Bank of Baroda	Grant Thornton	N	Medium
19	National Bank of Kenya	Delloite	Y	Medium
20	Bank of India	PKF	N	Medium
21	Imperial Bank Kenya	PKF	N	Medium
22	Dubai Bank Kenya	Delloite	Y	Small
23	Giro Commercial Bank	Delloite	Y	Small

24	Trans National Bank Kenya	Delloite	Y	Small
25	UBA Kenya Bank Limited	Delloite	Y	Small
26	Development Bank of Kenya	KPMG	Y	Small
27	Equatorial Commercial Bank	KPMG	Y	Small
28	Guardian Bank	KPMG	Y	Small
29	Habib Bank	KPMG	Y	Small
30	Habib Bank AG Zurich	KPMG	Y	Small
31	Paramount Universal Bank	KPMG	Y	Small
32	Charterhouse bank limited	KPMG	Y	Small
33	Credit Bank	PWC	Y	Small
34	Fina Bank	PWC	Y	Small
35	First Community Bank	PWC	Y	Small
36	Gulf African Bank	PWC	Y	Small
37	Middle East Bank Kenya	PWC	Y	Small
38	Victoria Commercial Bank	PWC	Y	Small
39	K-Rep Bank	Ernst & Young	Y	Small
40	Consolidated Bank of Kenya	Kenao	N	Small
41	Jamii Bora Bank	Patel, Shah and Joshi	N	Small
42	Fidelity Commercial Bank Limited	PKF	N	Small
43	ABC Bank (Kenya)	Deloitte	Y	Small
44	Oriental Commercial Bank	RSM Ashvir	N	Small

Source: Author, constructed from individual company's annual reports and the CBK Bank Supervision Report 2011 (CBK 2012)

II. Commercial banks' audit fees, listing and auditors

	Bank	Big 4 (Y/N)	Audit fees (KShs Million)	Listed (Y/N)	Total assets (KShs Million)
1	Cooperative Bank of Kenya	Y	8.2	Y	167,772
2	Equity Bank	Y	6.0	Y	176,911
3	Kenya Commercial Bank	Y	11.7	Y	282,494
4	Standard Chartered Kenya	Y	12.8	Y	164,182
5	Barclays Bank	Y	18.0	Y	167,305
6	CFC Stanbic Bank	Y	2.9	Y	140,087
7	Chase Bank (Kenya)	Y	2.4	N	36,513
8	Family Bank	Y	2.5	N	26,002
9	NIC Bank	Y	4.0	Y	73,581
10	Prime Bank (Kenya)	Y	2.5	N	74,647
11	Citibank	Y	6.3	N	74,646
12	I&M Bank	Y	6.9	N	76,903
13	Housing Finance Co. Of Kenya Ltd	Y	7.0	Y	31,972
14	Bank of Africa	Y	5.8	N	38,734
15	Commercial Bank of Africa	Y	6.4	N	83,283
16	Diamond Trust Bank	Y	11.5	Y	77,453
17	Ecobank Kenya Limited	Y	9.2	N	27,210
18	Bank of Baroda	N	3.2	N	36,703
19	National Bank of Kenya	Y	8.0	Y	68,665
20	Bank of India	N	2.3	N	23,352
21	Imperial Bank Kenya	N	1.8	N	25,618
22	Dubai Bank Kenya	Y	2.5	N	2,316
23	Giro Commercial Bank	Y	2.1	N	11,846
24	Trans National Bank Kenya	Y	1.9	N	7,287

25	UBA Kenya Bank Limited	Y	2.1	N	3,206
26	Development Bank of Kenya	Y	3.6	N	11,523
27	Equatorial Commercial Bank	Y	3.8	N	12,927
28	Guardian Bank	Y	3.6	N	8,836
29	Habib Bank	Y	2.2	N	5,861
30	Habib Bank AG Zurich	Y	2.6	N	8,722
31	Paramount Universal Bank	Y	1.8	N	4,727
32	Charterhouse bank limited	Y		N	-
33	Credit Bank	Y	4.2	N	5,394
34	Fina Bank	Y	6.8	N	14,630
35	First Community Bank	Y	5.8	N	8,740
36	Gulf African Bank	Y	4.7	N	12,915
37	Middle East Bank Kenya	Y	2.8	N	4,639
38	Victoria Commercial Bank	Y	3.1	N	7,645
39	K-Rep Bank	Y	3.0	N	9,319
40	Consolidated Bank of Kenya	N	2.9	N	15,318
41	Jamii Bora Bank	N	1.2	N	2,070
42	Fidelity Commercial Bank Limited	N	1.8	N	10,789
43	ABC Bank (Kenya)	Y	2.8	N	12,507
44	Oriental Commercial Bank	N	1.7	N	5,030