

**THE EFFECT OF BOARD COMPOSITION ON QUALITY OF FINANCIAL
REPORTING AMONG FIRMS LISTED IN NAIROBI SECURITIES
EXCHANGE**

By

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DECLARATION

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

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ABSTRACT

The main purpose of the study was establish the relationship between board composition and quality of financial reporting among listed firms at the Nairobi Securities Exchange. The study objectives was to determine the effect of board size, board independence, frequency of board meetings and presence of audit committees on quality of financial reporting among firms listed at the Nairobi Securities Exchange. The study was guided by the agency theory and institutional theory. The research design used in this study is the cross sectional and explanatory design with a population size of the 46 firms. Census technique was employed in the study and secondary data collected using documentary guide. Both descriptive and inferential statistics were used in analyzing the data. The study established that the board size and presence of audit committee has a positive and significant effect on the quality of financial reporting, while board independence and frequency of board meetings exhibited a negative and significant effect on the quality of financial reporting. Thus, the study concludes that increase in board size and presence of audit committees increases the level of financial reporting quality, while decrease board independence and frequency of board meetings increases the level of financial reporting quality. Therefore, the study recommends that there is need for a large board so that members of the board can distribute the workload and dedicate more of their time to monitoring. There is also need for firms listed in NSE to have at least four meetings in a year. It is also important for firms to have an audit committee so as to enhance the quality of financial reporting.

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ABBREVIATIONS

AC	Audit committee
AICPA	American Institute of Certified Public Accountants
AIMS	Alternative Investment Market Segment
BRC	Blue Ribbon Commission
CEO	Chief Executive Officer
CMA	Capital Market Authority
DAC	Discretionary Accruals
GDP	Growth domestic product
MIMS	Main Investment Market segment
NEDs	Non-Executive Directors
NSE	Nairobi Security Exchange
ROA	Return on Asset
USA	United State of America

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Lambert, Leuz, and Verrecchia (2007), Healy and Palepu (2001) have highlighted and emphasized on the aspect of financial reporting and its significance. They all indicated that it is a critical element of efficiency in investment. Prior research also showed that higher quality financial reporting enhances investment effectiveness (Bushman and Smith, 2001). Biddle and Hilary (2006) showed that organizations with higher financial reporting quality tend to experience higher investment productivity. Thus the underlying aim in financial reporting is to give financial data that is of good quality to capitalists and different stakeholders to aid them in settling on financial choices in a manner that enhances market productivity (IASB, 2008).

Banks (2014) argued that members of corporate board are vested with the obligation to settle on financial choices that influence the prosperity of financial specialists' capital, workers' security, groups' monetary wellbeing, and executive power and perquisites. The board is charged with oversight of day to day administration and agency theorists contend that to secure the interests of investors, the top managerial staff must accept its compelling oversight work (Uadiale, 2010). Board performance is also largely dependent on board structure, board size, duality of CEO, gender, skill set and board culture (Brennan, 2006). Thus, the board has a definitive internal power in an organization including its operational functionality (Renton, 1994).

Agency theory has been utilized as the prevalent way to deal with the role of boards and is often invoked to address the issue of the clashing interests of proprietors and managers. Zahra and Pearce (1989) noted that this issue is especially prevalent in blue-chip companies that are listed.

Fama and Jensen (1983) also noted that boards should go about as watch dogs and safeguard shareholders' interest through monitoring and control of the management and thus diminishing agency costs. Further the resource dependency theory contends that the board members have an external role connecting the firm to its outside operating environment, for example, through systems administration (Pfeffer and Salancick, 1978). Board members and especially those who are external can link the research problem existing between the company and its setting and fill in as a system for drawing in assets through investments.

Manyuru (2015) pointed out that the Kenyan Companies Act requires the directors of a company to prepare financial statements that presents reasonably the financial performance of a company in every fiscal year. Further the board of directors is required to ensure that the company maintains proper accounting records which are accurate, reliable and consistent in preparation (CMA, 2010). Nonetheless, in Kenya, rules regarding to obligatory quality of reporting are lacking, however, there are procedures within the ethical standards relating to financial reporting (Crowe Horwath International, 2016).

In Kenya, corporate governance has conventionally been a preserve of larger firms, essentially due to distinction of shareholding (ownership) and firm control. Although board composition as a component of corporate governance is gaining traction, a lot needs to be done especially on regulation and enforcement. Some listed firms have had tremendous governance problems including the unauthorized sale of shares, mismanagement and board conflict (CMA, 2014). Directors act as in internal regulating mechanism on management of the company particularly on matters of day to day operation that can be subject to management override and discretion and in the long run balance interest amongst investors, managers and partners of a company. An

appropriate legal framework is however necessary to define the roles of governing bodies, chief executives and the related framework of authorities and responsibilities of each level of corporate governance so as to enhance quality financial reporting.

1.1.1 Board Composition

Ongore *et al.* (2015) defined board composition as corporate board size, the mix of non-independent and independent board of directors and other essential traits such as gender diversity. Board composition is the number and the type of board members, board demographics, board structure, board education, number of meetings and evaluation, and board leadership (Zahra & Pearce, 2001). Other scholars have defined board structure/composition as the fraction of outside board members on the corporate board as compared to their non-independent (Uadiale, 2010; Lawal, 2012).

A corporate board should be composed of members having proper collective skill set to guide corporate strategy successfully (Johnson, 2010). According to Johnson, achieving this end through the initial selection of board members or adjusting the membership of an existing board is nevertheless an onerous task. This is because the board is charged with guaranteeing that the enterprise secures investors' rights, has sound operational controls in place and elevated amounts of straightforwardness and divulgence. The board is also in charge of coordinating and controlling day to day operations and is responsible to investors for its performance (Bowen 2008).

An effective executive is at the core of a well-functioning and well-governed corporation, as it acts as the ultimate internal monitor. In a perfect world, the board directs long term corporate

trajectory, sets up the key specialists to actualize it, and measures performance against the set objectives. Thus, organizational nonperformance and misadministration stems from a nonfunctional or ineffective board. Be that as it may, practically by definition, boards of director's work encapsulate general public, investors' and stakeholder interests. As such the idea of confidential board makes it difficult to request full disclosure of board meetings happenings, and only places reliance on trust in the best possible working of the Board (Abor 2007).

Board composition is made up of size of the corporate board, board meetings, board members tenure, board independence, existence of audit committees, gender balance and others aspect of board diversity like age and education backgrounds (Arshad and Muhammad, 2009). However, this study will make use of four aspects of board composition structure for example the corporate board size quantified as the number of members (Arshad and Muhammad, 2009), degree of board independence based on the number of independent directors compared to full time directors, board meetings frequency taken as the number of meetings held in a year and presence of an audit committee which will be measured as a dummy hence corporate audit committee presence will be denoted as 1 and 0 if there is none.

1.1.2 Quality of Financial Reporting

Verdi (2006) noted that financial reporting of desirable quality is based on the precision with which the financial reports convey clear and accurate information about the organizations results, particularly its cash flows, and as such provide advise to capital investors. Other scholars such as Tang *et al.* (2008) noted that it is the degree to which the financial statements transparently reveal the financial position of an organization. The need for quality financial reporting has increasingly attracted the attention of regulatory players, scholars, investors and the accounting

professionals. Johnson *et al.* (2002) noted that this is because financial reporting remains the main method of communicating to the external users and assessing financial performance, (Warre and Reeve (2004) in their endeavor to assess the actions of the management and aid in the making of financial choices. Alsaeed (2006) and Haniffa and Cooke (2002) highlighted that several elements have been examined by past scholars as substitutes for quality financial reporting and among these proxies is compliance with accounting and audit standards disclosure requirements.

The number of accruals is also a yardstick where organizations with more accruals are associated with low quality financial records and vice versa (Rahman and Ali, 2006 and Yang and Krishnan, 2005). Further the degree of voluntary disclosures as measure has been used (Haniffa and Cooke, 2002 and Alsaeed, 2006). This is based on the contention that since there is insufficiency of compulsory information; investors can access available information from the voluntary disclosures to make more informed decisions (Alsaeed, 2006). This study will use prior literature to construct a measurement tool and definition based on the number of accruals.

1.1.3 Effect of Board Compositions

The degree of independence of the board from the management determines the capacity of the board to operate efficiently as an instrument. Based on the agency point of view, non-executive directors are relied upon to furnish investors with heightened assurance in monitoring administration. This enhanced monitoring capacity is hinged on the motivation to keep up their reputation in the labor market. The executive's responsibility is to monitor with a focus on the shareholders (Leng & Chang, 2011). Further, Abdullah and Mohd-Nsir (2004) asserted that the corporate board structure is taken as the most efficient and effective way of board of directors

and particularly management when laying down processes that enhance the value of the firm. Vethanayagam *et al.* (2006) affirmed the main focus of the board and its effect on productivity.

Myring and Shortridge (2010) utilized ranked regression analysis in the US to investigate board structure as components of corporate governance and how it affects financial disclosures. The results were mixed but evidently supported the forte of board structure as a determinant of quality financial statement information. Fathi (2013) carried out study on how corporate governance relates with financial information quality in Tunisia and the findings demonstrated a positive relation between financial information qualities and board characteristics. Kantudu and Samaila (2015) further demonstrated that financial reporting qualities is impacted by separation of functions, presence of independent directors, managerial shareholdings and existence of audit committees.

A broad and overreaching discussion on board composition and quality of financial reporting has been ongoing especially in industrialized countries with a focus on various elements of board composition. Recently, attention has been drawn to the investigation of the composition of the board and financial reporting in developing economies which have experienced rapid and unexpected growth and have unique characteristics related to corporate control, allocation of capital and laws (Dimitropoulos and Asteriou, 2010).

1.1.4 Nairobi Securities Exchange

In Kenya, as noted by CMA (2010), Nairobi Securities Exchange (NSE) is the single major open capital market in the country. For a long time, companies at the Nairobi Securities Exchange operated without clear control and directorship structures thus presenting corporate governance

concerns among stakeholders. Changes have since been witnessed in terms of corporate governance rules and standards. Further there have been enhancements in the procedure and structures used to coordinate and regulate business among listed company's regulations on corporate accounting with a definitive target of acknowledging investors long term value while considering the interests of different stakeholders (CMA, 2000).

In Kenya, board structure in corporate governance has conventionally been linked with larger companies, mainly because of the split between firm control and ownership structure of the firm. Despite the fact that corporate governance is gaining some level of recognition, a lot needs to be done especially on regulation and enforcement. Some listed firms for instance have had tremendous governance problems including the unauthorized sale of shares, mismanagement and board conflict (CMA, 2014). The board, as inward system of administration plays a key role in the exercise of administrative caution and linking day to day operations with strategy and thus stakeholder interest. Positive changes in the management of many firms are hence critical if the universal endeavors to stop corruption as well as other forms of irregularities are to attain the envisaged objectives. A responsive legal structure is required to describe the objectives of bodies that govern and chief executives and the accompanying structure of authorities and accountabilities of each board composition level as a mechanism of governance to improve quality of financial reporting.

Financial reporting among Kenya's listed firms is guided by International Financial Reporting Standards (IFRS). Kenya's choice to ascribe to IFRS was solely based on various market factors in the 1990s. During this period, there were various institutional collapse and failures such as in the banking sector and later, attempts to privatize many government owned organizations. These

factors brought about a synchronous push for expanded corporate administration, a developing enthusiasm for the capital markets and a resulting push to embrace IFRS (UN 2006). The choice to likewise have privately owned businesses embrace IFRS flourished in control set up at the advent of Kenyan Companies Act which demanded that all firms have to publish records of financial performance. However, the Act doesn't specify reporting benchmarks that ought to be actualized. In Kenya, ICPAK regulates the practice of accounting through legislative regulations that is enshrined in law. ICPAK has implemented IAS and IFRS because of the requirement to have a standard set of measure for all organizations and the practicability of this based on a management view as they are universally recognized. However in instances where a given standard is not applicable or practical in the context of a private company, the firm would not base their decisions on the standard in its financial practices and processes (Owusu-Ansah, 1998).

Given the expanding measure of concentration on and the increasing importance of the NSE as a critical scene for pulling in foreign investment and to urge locals to put resources into shares, Kenyan organizations may participate in both obligatory and deliberate exposure to improve the estimation of their stocks. However, it is not apparent how board composition reforms have impacted on financial reporting quality. Challenges and gaps in corporate governance, slow uptake financial information and the overall lack of transparency within the corporate sector act as the major barriers in corporate financial reporting in Kenya.

1.2 Research Problem

Financial reporting of desirable quality is important for the effective distribution of resources in the capital markets. Nature or quality of financial reporting does mean income or stock value

changes. It is a multi-faceted term needing far reaching measures of value accounting information (IASB, 2008). The increase in financial malpractices and the loss of finances in Kenyan state corporations, selective reporting and variation in quality of information disclosed has been highlighted in surveys. There were two main business surveys conducted in 2009; Business Indicator Index (KIBII) which positioned Kenya at number 71 out of 100 countries with a score of 6.48 out of 12 and the E-benchmarks forum index in which Kenya was positioned at number 72 out of 100 (Outa, 2011). These indices demonstrated that there was minimal conformity with International Financial Reporting Standards (IFRSs) in Kenya.

Market benefits like expanded securities exchange movement were witnessed after ICPAK's enforcement of reforms in financial reporting and in particular as result of conformity with IFRS in reporting. The reception of IFRS has additionally reduced difficulties in disclosure requirements among firms since IFRS updates are succinct and are contextualized by the professional regulator. Firms in NSE are also facing similarly difficulties, according to Capital market report (2010) some of the financial statements report prepared by some firms are inaccurate, unreliable and inconsistent.

Recent research by La Porta *et al.* (2006), Nabar and Boonlert U-Thai (2007), Daske *et al.*(2008), Leuz *et al.* (2003) and Ball *et al.* (2003) recommends that effective board composition are significant elements of high financial reporting quality. The work of Ugbede *et al.* (2013) and Leslie and Okoeguale (2013) only used Audit committee size as the independent variable. Similarly, Audit committee size and audit committee independence as independent variables were used by (Fodio *et al.*, 2013). Hassan (2012) on the other hand used aspects of board independence and audit committee meetings as independent variables. In Kenya, in a study on

effect of structure of the corporate board on firm performance in NSE by Muriithi (2008), it was revealed that the non-executive directors' influences firm output positively. The interrelations among ownership, board and manager characteristics and the performance of the firm using a sample size of 54 listed companies in NSE also indicated a positive and significant relationship due to effect of managerial discretion on performance of the firm as per the study by (Ongore, 2011). This study purposes to fill the gap by evaluating how board size, board independence, board meetings and audit committees affects quality of financial reporting. Based on the above argument, the study seeks to answer the following question; what is the effect of board size, board independence, frequency of board meetings and presence of audit committees on quality of financial reporting in firms listed at the Nairobi Securities Exchange?

1.3 Objective of the study

The primary objective of this study was to establish the relationship between board composition and quality of financial reporting among listed firms at the Nairobi Securities Exchange.

1.3.1 Specific objectives

The study specific objectives were:

- i. To determine effect of board size on quality of financial reporting among listed firms in NSE
- ii. To establish effect of board independence on quality of financial reporting among listed firms in NSE
- iii. To identify effect of frequency of board meetings on quality of financial reporting among listed firms in NSE

- iv. To identify effect of presence of audit committees on quality of financial reporting among listed firms in NSE

1.4 Significance of the Study

The study helps in theory development by giving insights to the best practices in relation to board composition and its measured impact on quality of financial reporting. The study further highlighted opportunities for enhancement of best practices for adoption in board composition.

Scholars used the findings of this study as a benchmark for future investigations and pursuit of detailed knowledge on composition of boards as an efficient means of adopting quality financial reporting. Furthermore, it aids researchers in pursuing knowledge on the composition of boards and the practices to adopt and manage the gaps identified in financial reporting.

Policy makers find this study important in developing and enhancing policy pronouncements within the realms of governance in pursuit of enhanced financial reporting. The policies developed also aid in focusing board composition as a significant economic foundation for attracting more investments to the CMA.

Managers of firms listed in NSE also benefit from the findings especially in the implementation of board decisions, strategic plan and in management of board composition in its quest to enhance quality of financial reporting. Managers also gain insights on board composition as a mechanism of improving financial reporting standards.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter collates literatures from past researchers and scholars on the effect of board composition on financial reporting quality. The chapter examines the concepts and theories on financial reporting quality. By considering the work from diverse past authors, the chapter shapes the theoretical and the conceptual framework of the study on the effect of board composition on the quality of financial reporting of firms listed in the NSE.

2.2 Theoretical Framework

Uma and Sekeran (2010) defined a theoretical framework as a conceptual model that theorizes or makes logical sense of the relationships among the several variables identified as important to the problem under investigation. The theory flows logically from the documentation of previous research in the problem area by identifying the theories related to the study. This study will be guided by the agency and institutional theories and the analysis of these theories will link them to the study and bring out existing research gaps

2.2.1 The Agency Theory

The study will be informed by agency theory by Jensen and Meckling (1976). The theory shows the distinction between control of the firm and ownership by creating conflicts of interest amongst the managers and the stakeholders. Consequently, Kalbers and Fogarty (1998) indicated that organizations have the responsibility to utilize control structure to minimize agency costs. In addition, it has been contended that board organization or composition is utilized basically in

cases when there are high agency costs to enhance quality of reported information from the agents to the principals. The agency theory indicates that to guarantee the viability of board structure, managers are urged to get ready financial statements satisfactorily to determine the return produced by organizations. The agency hypothesis expresses that the existence of independent executives in the board is sufficient to guarantee financial reports unwavering quality. Beasley (1996) presumed that board composition does not really imply that this board is powerful in playing out its oversight responsibility. Felo *et al.* (2003) concentrated on the agency theory and indicated a significant link between the presence of a board composition and the nature of financial reports. The theory is applicable to the study by the fact that board of directors are urged to get ready financial statements satisfactorily to determine the return produced by organizations. As such this study will apply agency theory in an attempt to show how board composition is connected to quality of financial reports. .

2.2.2 The Institutional Theory

Many studies such as Scott (1995) and Zaman (2002), on board composition have relied on an institutional view. DiMaggio and Powell (1983) indicate that the institutional theory is described by the notion that a firm is comprised of cultural, social and the broader institutional setting. The appropriation and the operation of board structure were talked about in view of this point of view to the degree it proposes that the audit committee can impact and be affected by an assortment of operators (Zaman, 2002). Zaman (2002) points out that this point of view can upgrade the responsibility of expert bodies, for example, audit committees of trustees on advancement of administrative authority and to perform better in capacity of checking and control productively, which a few scholars Bryan *et al.* (2004) and Klein (2002) have focused on the significance of

specific attributes identified with the individuals that shape the board. In like manner, Vienot (1995) gives that the board composition principle assignment is "to guarantee the pertinence and consistency of the bookkeeping approaches received for the financial reports and confirm that the interior systems for collecting and checking information promise them. In a similar way, Spira (2003) points out that the audit committee members play the role of protecting the investor interests and reduce and address agency challenges defined by asymmetries of information. Moreover, the audit committee is a viable body to secure the interests of investors and guarantee the unwavering quality of information provided (Spira, 2003). Under the institutional hypothesis perspective, audit committee exercises might be just approximately combined with cases of board composition adequacy, to such an extent that the official audit committee exercises are basically stylized/ceremonial and intended to make authenticity outside the association. The institutional hypothesis proposes that board composition viability is more inferable from inside components, for example, points secured by the audit committee than to outside elements, for example, agency factors (Kalbers and Fogarty, 1998). Accordingly this theory was used and contended that public accessible information is of restricted use in assessing the truth of the audit committee being one of the center corporate administration structures and its productivity as per (Kalbers and Fogarty, 1998). This theory recommends that one reason for the AC is to motion to investors that the board can skillfully oversee administration (Cohen *et al.*, 2008). This study utilized this theory in showing operation of boards in ensuring that quality information is disclosed to stakeholders and investors

2.3 Determinates of Quality Financial Reporting

The structure of the board is a determinant/element of the degree of financial reports quality. The factors that feed reporting quality about firm attributes can be categorized as structure, performance and market. This study focused on leverage, profitability, listing status and industry factors

2.3.1 Leverage

A firm with a higher proportion of debt has a motivation to increase its financial reporting/disclosure. In this case creditors can assure themselves by prohibitive agreements owing debtors (Jensen and Meckling, 1976). Botosan and Plumlee (2002) note that managers have motivating forces to reduce agency costs by building divulgence. It reduces agency expenses and prompts to lenders the evaluation of risk of the firm. Lenders probably request that more information protect their investment. From these clarifications, this study anticipates that the connection between financial information quality disclosure and utilization is known.

2.3.2 The Profitability

Inchausti (1997) showed the use of signaling theory in linking firm productivity and disclosure of information and enhancement of the reputation of the firm. Wallace, Naser, and Mora (1994) asserted that profitability of the organization demonstrates data that might be of enthusiasm to clients of financial information. It is often contended that the manager of highly profitable firms discloses more financial information in motivating powers that are either signaling or unfriendly (Lang and Lundholm, 1993, Verrecchia 1983). Akhtaruddin (2005) points out that companies are likely to disclose data when the outcome is more profitable.

2.3.3 The Industry

According to Leventis and Weetman, (2004), the type of Investment can be taken as a determinant for financial information disclosure. For instance, production firms have qualities that relate to disagreement, item detachment, advancement, request unconventionality, and risks. Dye and Sridhar (1995) asserted that these associations may have a structure for the isolated disclosure system. In this study, it thus expected that there is existence of an association between type of industry and financial disclosure.

2.3.4 The Listing Status

The factor that reveals the variability of disclosure of financial information is listing status. There are mainly three types of listing status: unlisted, listed just on solitary exchange securities trade or the local market or referred to on a couple of securities trade (different listing). An IPO is an inspiring enabler in reducing the conflicts among the contracting parties (Fama and Jensen, 1983). Different listing status levels among organizations means different information disclosure given that they have specific and different goals on change and capital improvement. Associations with different listing are planning to increase their activities internationally (Cooke, 1991). On the other hand, multiple listing enables the concerned organization to gain in business and also meet information needs by local and international clients. In addition, it enables access to a more liquid financial market that is also less divided than local markets only. At the point a firm has to meet its responsibilities in terms of additional information disclosure before it is listed on the international market compared to the local market. This means that there is a possibility of now acknowledging that the information disclosure quality is higher in multiple listed firms.

2.3.5 Board Composition

There are various characteristics of the board that define disclosure in a firm. Several theoretical and experimental investigations inspected this phenomena (Barako *et al.*, 2006 and Cheung, 2010; Clarkson *et al.*, 2003) on the size of the Board, the existence of non-executives and the participation of Board individuals at meetings.

Board size is defined as a decreasing limit of the suitability of control. While adding another responsibility to the best administrative staff redesigns the board's oversight responsibility. Nevertheless, the marginal cost of an additional part similar to controlling and disclosure of information (Jensen, 1993). For this circumstance, the agency cost increases with increase in board members.

The degree of self-governing administrators can be officers of different associations or agents of financial associations. In light of their experience, autonomous board members can challenge decisions made by managers and in this way, rehearse more reasonable control. The independent board members go about as a strong framework to diminish association conflicts among executives and financial specialists (Fama and Jensen, 1983). They give the basic checks to upgrade the operations of the board members (Franks *et al.*, 2001). Fama (1980) points out that independent board members endeavor to improve their value. Arcay and Vazquez (2005), Haniffa and Cooke (2002), have showed the impact of independent board members on the financial information disclosure.

The meetings held by directors and the active participation of the members in such meetings is highlighted as a factor of the development of the board (Xie *et al.*, 2003; Vafeas, 1999). Ben

Ayed-Koubaa (2010) points out that the board meeting frequency can be considered as an antecedent of the quality of the financial information reported and is strengthened more with the degree or level of participation in the meetings.

2.4 Review of Empirical Literature

This part reviews the empirical studies on the relationships among board composition aspects (board independence, board size, frequency of meetings held by board members and audit committee presence). A summary of the empirical literature reviewed identifying the research gaps is presented and forms the basis for the diagrammatic development of the conceptual model

Global Studies

Abor and Biekpe (2007) carried out investigations on board composition and its effects and their results showed evidence of a negative effect of board size on disclosure of leverage ratios and small and medium enterprise with bigger boards generally having low level of reporting. Nonetheless, a significant effect of corporate board size and disclosure of financial information was identified by Wen *et al.* (2002). They contended that bigger boards take after an arrangement of more elevated amounts of equipping to upgrade firm value particularly when these are dug in because of more noteworthy observing by administrative experts. It is additionally contended that bigger board may discover trouble in landing at an accord in basic leadership which can at last influence the nature of corporate administration and will eventually affect financial reporting/disclosure/

Anderson (2004) found that the financial disclosure is smaller for bigger boards than small board. The directorate is at the center of the association's inward administration structure. It is

additionally a perceived unit in the main line of resistance to shield the partners' interests from being sub-used by managers (Daily *et al.*, 2003). What's more, the directorate can help limit the desire hole amongst partners and the top managerial staff (Brennan, 2006).

In this way, comes about a positive effect of board size on capital structure disclosure (Abor, 2007). Their disclosures infers that a bigger board monitors managerial bodies, look after higher leverage to raise firm value. Moreover, a greater board enlistment could achieve inconvenience in meeting up at an understanding in fundamental administration. These disputes emerging out of more prominent size of the board have the inclination of incapacitating board composition achieving high leverage disclosure. Firms with greater boards generally have low levels of implementing disclosure decision because greater boards create pressure on directors to report more on gearing levels and enhance firm performance (Anderson *et al.*, 2004).

Khan and Kotishwar (2011) demonstrated that a dependent board or independent board of director's screen and control the chairperson. They are the connection with the outside setting and offer a worldwide view. Aside from this, autonomous executives endeavor to enhance board processes and get specialist knowledge, they give congruity, help recognize organization together and procurement. Along these lines, autonomous directors help keep up a moral atmosphere in the association. Also, Otchere, Bedi and Kwakye (2012) contend that the independent board is to be seen as the check and adjust technique to build the viability of the board.

A relationship between the level of board independence and the quality of financial information was not found by Anderson *et al.* (2004), while Gisbert *et al.* (2011), despite initial predictions that pointed towards a positive effect between the two factors, their results showed that the

presence of independent directors did not contribute to increasing credibility nor the disclosure of accounting information.

This finding concurs with Oxelheim and Randoy (2003), that board members meetings have effect on firms' information disclosure. These scholars contemplated firms in the Scandinavian countries and investigated the connection between board size and firms' values, principles and controls. They found that firms which had no less than one foreign board member performed better than those who did not. They presumed that foreign board members can bring an assortment of experiences and ability, which can profit the firms.

Comparative discoveries with respect to board composition and frequency of their meetings were uncovered by Hartarska and Mersland (2012). These examinations characterized performance as proficiency in achieving an excessive number of poor customers. Past literature has explored the responsibility of the size of audit boards of trustees as a successful system for observing and controlling financial reporting. Anderson *et al.* (2004) showed that a few board members improves firm value. They attested that having few board individuals enhances the productivity of audit committee observing and control. They set that substantial board size is related with delays and regulatory bottlenecks.

Klein (2002) confirmed that presence of audit committees increase level of financial disclosure. Beasley *et al.* (2000) revealed that presence of audit committees is in a general sense associated to disclosure quality, since financial report misrepresentation is significantly inclined to occur in firms without audit committee. In any case, extraordinary examinations found various results. Lin *et al.* (2006) uncovered irrelevant relationship between autonomous audit committees and

wage repetitions. Xie *et al.* (2003) similarly demonstrated immaterial association between the level of optional accumulations and autonomous audit committee.

Zainal *et al.* (2009) revealed that a higher degree of independent directors increases financial reporting quality due to their experience variety, characteristics, traits and ability, which may upgrade essential initiative structures. Independent directors are accepted to be in a better position than administrators to fulfill their checking limit since they are autonomous and stressed over keeping up their reputation in the external labor condition. Foreseeable with this recommendation, a positive connection exists between firm financial disclosure quality and size of independent board members on the AC. Ameer *et al.* (2010) induced that firms with external board members are depended upon to have a predominant quality financial reporting appeared differently in relation to those firms that have a lion's share of internal executives in the AC. Audit committee independence influences firm's income, management and investors activities. Klein (2002) indicates that decreasing the level of audit committee independence results in big increases in accruals.

Local studies

Hussein and Kiwia (2009) investigated effect of frequency of board meetings on disclosure of information in terms of complying with rules and regulations and their findings indicated a positive effect firm value and board gender. Barako *et al.* (2006) examined the connection between board qualities or attributes in meetings and how as often as possible they meet and willful disclosure in Kenyan listed firms. Their outcomes as to board structure uncover a negative connection between independence board members and willful disclosure, which

suggests that external board members don't make much difference with regards to persuading organizations to disclose information.

A study carried out by Kerich (2006), examined the effect of board frequency meeting and performance of firms listed in NSE. The scholars focused on the size of the board characterized as number of board individuals, board characteristics characterized as extent of external board individuals and top management experience characterized as far as whether the CEO originates from another nation. They contended that the more board individuals meet impacts the level of quality of financial reporting. Their outcomes with respect to board meetings were found to partially and positively impact firm's financial performance and consistence of guidelines and controls. They additionally detailed that small size in board meetings were powerful only to specific numbers, after which it ends up plainly ineffectual.

2.4 Summary of Literature Review

Through review of literature the study has identified some gaps in the existing literature. For example, most of the studies had small sample sizes that could not provide reasonable conclusions. Hence, there is the need of more research with large sample sizes. In addition, most of the studies showed effect of specific board composition aspect but not the entire corporate governance (board composition elements on financial reporting quality) (Honu & Gajevszky, 2014). This indicates that there should be further research on how all aspects of board composition combined to affect quality of financial reporting (Hashim, 2012). Furthermore, most of the studies were on specific sectors such as banks or manufacturing firms. Thus, it is paramount to consider a sample size that is diverse and included all firms from different sectors. There should also be emphasis to ensure that there are enough controls on all variables that might

threaten the results of the studies. This is because several studies indicate financial reporting quality is not determined by accounting standards only (Walker, Zeng & Lee, 2013)

In bridging this gap, this investigation will give different commitments to the current assortment of literature on board structure and the quality of financial disclosure. This investigation will conform to board composition in the Kenyan setting consequently a potential ramification for controllers and Kenyan capital market policy makers in improving adequacy of board composition principles of listing firms. The outcomes will likewise give a benchmark to inquire about in smaller countries with institutional, monetary and legitimate setting like that of Kenya.

2.5 Conceptual Framework

Drawing from agency theory and previous studies the independent variables in the study will be board size, independence, frequency of meetings and presence of audit committee which are assumed to have a relationship with quality of financial reporting (dependent variable). The conceptual framework is presented in Figure 2.1. from the below diagrams the study anticipates that board size, board independence, board frequency of meetings and audit committee experience are likely to influence quality financial reporting either positively or negatively

Independent Variables

Dependent Variables

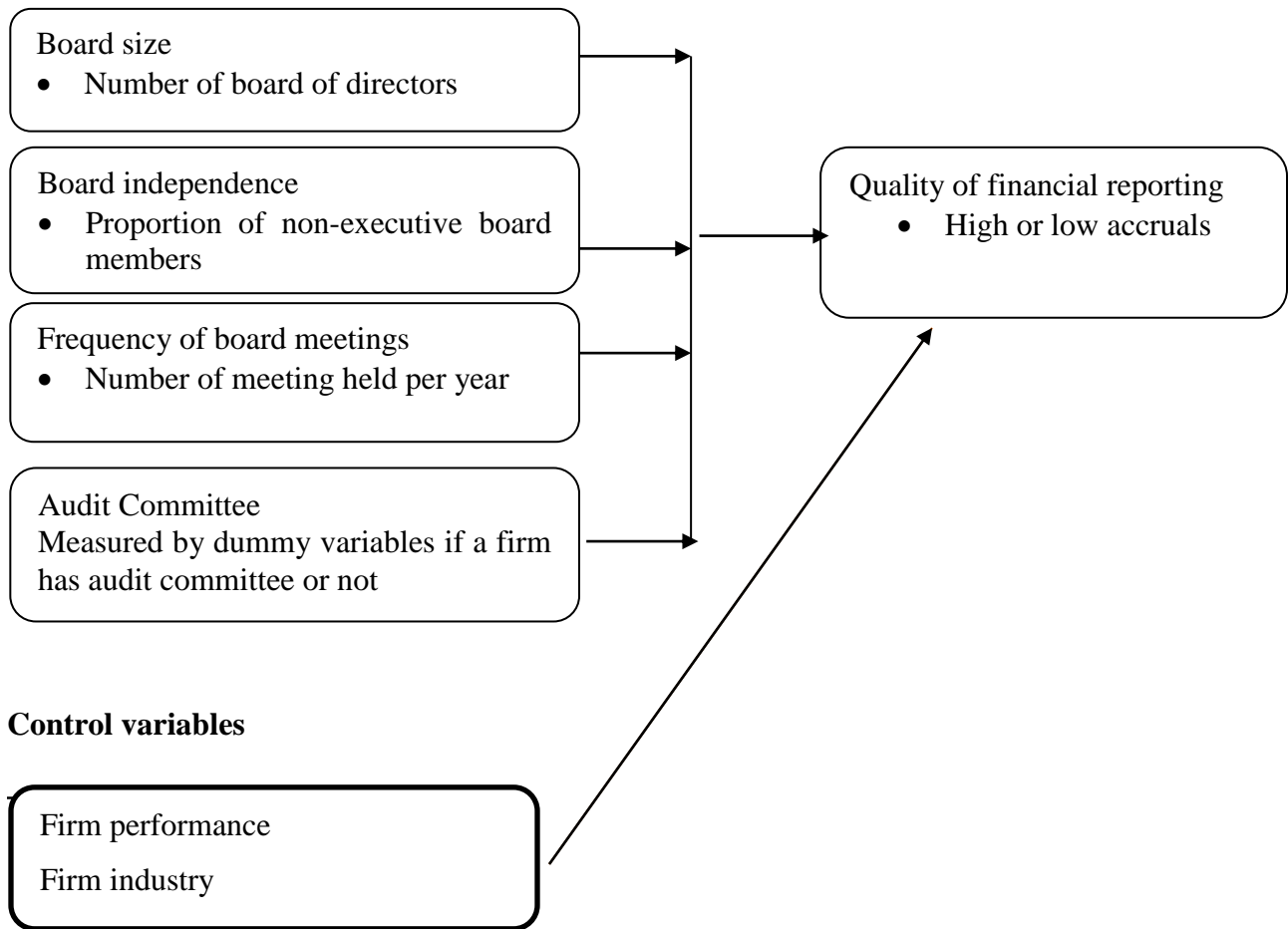


Figure 2.1: Conceptual Framework,

Source: Researcher (2017)

CHAPTER THREE

RESEARCH METHODOLOGY

3.0 Overview

This section comprises the research design, target population, sampling procedures and the sample size, data collection procedure, data analysis and presentation, measurements of variables.

3.1 Research Design

The study adopted cross sectional and explanatory studies. In a cross-sectional research, the information about I and J collected represents what is taking place at a given point in time only. The study could for example, look at educational level, age, gender, and experience. Bertrand and Schoar (2003) pointed out that research design has significant controls for the firm specific. Explanatory studies usually explore the causal relationship between measures of different variables obtained from the same individual at approximately the same time to get better understanding of factors that contribute to a more complex characteristic (Martens, 2009). These designs were chosen because it applied closely to the research objectives of the study and are practical in testing the study hypotheses.

3.3 Target Population

All listed firms at Nairobi Securities Exchange make up the target population of the study. There are 64 listed firms trading at the NSE and therefore the target population above was chosen since the data required by the researcher is easily accessible. Listed firms are either categorized as the

main market segment or alternative investment market segment. (Nairobi Securities Exchange, 2012).

A survey of all firms that have been operating in NSE over the study period was conducted. The population size of the 46 firms was arrived after eliminating the number of firms delisted, suspended, terminated and with missing data. Survey study ensures that no coincidental component of is left and highest accuracy is obtained (Kothari, 2009).

3.4 Data Collection

Secondary data was used by utilizing content analysis obtained from yearly financial reports of the listed companies, annual investors' reports, magazines and articles. Content analysis comprises the analysis of documentary materials (Kothari, 2004). Content analysis was chosen due to its popularity in collecting secondary data (Berreta and Bozzolan, 2004; Mohobbot, 2005; Hussainey and Elzahar, 2012). A document analysis guide prepared in Appendix I was used to enable and guide collection of data on firm and AC characteristics of the selected listed companies and the extent of their quality financial reporting. According to Oso and Onen (2005), document analysis is an instrument for collecting unobtrusive information.

3.5 Data Analysis

Data collected from the field was coded, cleaned and keyed into a pre-developed database for analysis using SPSS. Data analysis was conducted using descriptive and inferential statistics.

3.5.1 Descriptive Statistics

Data collected was analyzed by using descriptive statistical methods including mean, standard deviation, measures of skewness and kurtosis. Descriptive analysis, summarizes data set and processed for testing preliminary data, reliability, testing hypotheses and findings relation and strength of relations between variables.

3.5.2 Model Specification

Inferential analysis which included Pearson correlation and multiple regression model were heavily used as required for this research, with a significance alpha value = .05 with the aid of SPSS.

The model which was used in this study is given as;

$$Y = \beta_0 + \beta_1 FP_1 + \beta_2 FI_2 + \varepsilon \dots \dots \dots 3.1$$

Y is the measure of QFR

β_0 is the constant of the equation;

β_1, \dots, β_4 are parameters to be estimated;

FP_1 is the firm performance

FI_2 is the firm industry;

$$Y = \beta_0 + \beta_1 BS_1 + \beta_2 BIx_2 + \beta_3 BFM_3 + \beta_4 AC_4 + \varepsilon \dots \dots \dots 3.2$$

Where;

Y is the QFR;

β_0 is the constant of the equation;

β_1, \dots, β_4 are parameters to be estimated;

BS_1 is the board size;

BI_2 is the board independence;

BFM_3 is the board frequency of meeting;

AC_4 is the presence of audit committee and;

ε is the error term.

3.5.3 Operationalization of variables

	Variable Name	Variable Symbol	Measurement	Author
Dependent	Quality of financial reporting	QFR or Y	Measured by use of accruals quality as a proxy for financial reporting which is Δ current assets - Δ cash - change in current liabilities + Δ short term debt-depreciation) /scaled by average total assets	Dechow and Dichev (2002)
Independent variable				
	Board size	BS	Measured by the total number of board of director in the firm	Henry (2010)
	Board independence	BI	Proportion of the total board composed of non-executive directors	Cheng and Courtenay, 2006
	Board frequency of meeting	BFM	Number of meeting held per year by board directors	Henry, 2010; and Khan, 2010

	Audit committee	AC	The existence of an audit committee during the period was coded 1; otherwise 0 during the period was coded 1; otherwise	Henry, 2010; and Khan, 2010

3.6 Ethical Consideration

The data collected from the NSE was solely used for the purposes of this study and was not forwarded to any other party. The researcher utilized this information to construct a database that was analyzed to give results. Given the fact that listed companies in the NSE are public limited companies, information relating to their profitability and share prices is made available to the members of the public since their offices are public offices where these documents are kept.

CHAPTER FOUR

DATA ANALYSIS, PRESENTATION AND INTERPRETATION

4.1 Introduction

This section provides a presentation of research findings of the empirical research on the direct relationship between board size, independence, meetings, audit committee, return on asset on the quality of financial reporting.

4.2 Descriptive Statistics

Findings showed that the firms listed in NSE had an average of five members in the board (mean = 5.6087) with 96 percent of the members being independent directors (mean = 0.96654). Besides, 50% of the board members were in the audit committee (mean = 0.5). The board meetings were held at least twice a year (mean = 2.45652). Moreover, the return on assets was at a mean ration of 0.74617 meaning that most of the firms were performing well. More findings revealed that QFR were at a mean of - 0.1146, this shows that there is low quality of financial reporting. (See Table 4.1).

Table 4.1 Descriptive Statistics

	N	Min	Max	Mean	Std. Deviation	Skewness	Kurtosis
Board Size	46	2.000	15.00	5.6087	3.349814	1.455	1.167
Board Independence	46	0.333	1.00	0.96654	0.120193	-1.096	1.127
Board Meetings	46	1.000	6.00	2.45652	1.361478	0.537	-0.727
Audit Committee	46	0.000	1.00	0.50000	0.505525	0.000	-1.093
ROA	46	0.000	4.77	0.74617	0.937615	2.457	1.430
FRQ	46	0.690	0.88	-0.1146	0.23298	1.174	1.843

Source: Researcher (2017)

4.2 Diagnostic Statistics

Before running regression model, it is necessary to ensure valid model assumptions. In case of any violations, consequent inferential measures may be invalid ensuing in faulty deductions. Consequently, it is essential to perform suitable model diagnostics. This section gives a description of the robustness tests for reliability and validity of the data. The tests include; linearity, normality, homoscedasticity and autocorrelation.

4.2.1 Linearity Test

The study tested linearity using ANOVA model through test of linearity. Findings indicated that there was linearity for quality of financial reporting versus board size ($p < 0.05$). This was also confirmed by deviation from Linearity which had p value > 0.05). Similarly, quality of financial reporting versus board independence had linearity p value less than 0.05, while deviation from linearity had p value more than 0.050. Moreover, QFR versus board meetings, QFR versus audit committee, QFR versus ROA, QFR versus firm industry had linearity with $p < 0.05$, and deviation from linearity had $p > 0.05$. This indicates the assumption of linearity was not violated. A summary of linearity test is presented in table 4.2.

Table 4.2 Linearity Test

		Sum of Squares	Df	Mean Square	F	Sig.
FRQ * board size	(Combined)	0.263	11	0.024	0.373	0.958
	Linearity	0.073	1	0.073	1.131	0.005
	Deviation from Linearity	0.191	10	0.019	0.297	0.977
FRQ * board independence	(Combined)	1.021	4	0.255	7.356	0.000
	Linearity	0.717	1	0.717	20.68	0.000
	Deviation from Linearity	0.303	3	0.101	2.914	0.046
FRQ * board meetings	(Combined)	0.379	5	0.076	1.47	0.221
	Linearity	0.287	1	0.287	5.57	0.023
	Deviation from Linearity	0.092	4	0.023	0.445	0.776
FRQ * audit committee	(Combined)	0.116	1	0.116	2.193	0.146
FRQ * ROA	(Combined)	2.357	38	0.062	5.092	0.016
	Linearity	0.374	1	0.374	30.738	0.001
	Deviation from Linearity	1.983	37	0.054	4.399	0.024
FRQ * firm industry	(Combined)	0.442	10	0.044	0.774	0.652
	Linearity	0.009	1	0.009	0.153	0.008
	Deviation from Linearity	0.434	9	0.048	0.843	0.582

Source: Researcher (2017)

4.2.2 Test of Normality

From table 4.3, Kolmogorov-Smirnov findings indicated that ($p > 0.05$) thus not significant and hence showing normal distribution. In addition, also Shapiro Wilk was not significant ($p > 0.05$) indicating that the distribution of the data was normal. This infers that the sampling distribution of the mean is normal and the distribution of means across samples is normal. Therefore, statistical errors such as outliers have been catered for.

Table 4.3 Test of Normality

	Kolmogorov-Smirnova		Shapiro-Wilk	
	Statistic	Sig.	Statistic	Sig.
board Size	0.239	0.171	0.839	0.089
board Independence	0.529	0.081	0.264	0.133
board meetings	0.27	0.181	0.83	0.081
Presence of audit committee	0.154	0.092	0.942	0.226
Firm performance	0.217	0.087	0.728	0.091
QFR	0.16	0.067	0.852	0.062

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

Source: Researcher (2017)

4.2.3 Test of homoscedasticity

The study tested homoscedasticity using White test as illustrated in results under Table 4.4. The findings indicated that Chi2 (16) was 27.35, p value of 0.8027 suggesting that assumption of homoscedasticity was not violated. Figure 4.1 shows the assumption homoscedasticity was not violated as there was no clustering or systematic pattern. The null hypothesis was the presence of homoscedasticity while the alternative hypothesis was the presence of unrestricted heteroscedasticity.

Table 4.4 Test of Homoscedasticity

chi2(16)	27.35
Prob > chi2	0.8027

Source: Researcher (2017)

Normal P-P Plot of Regression Standardized Residual

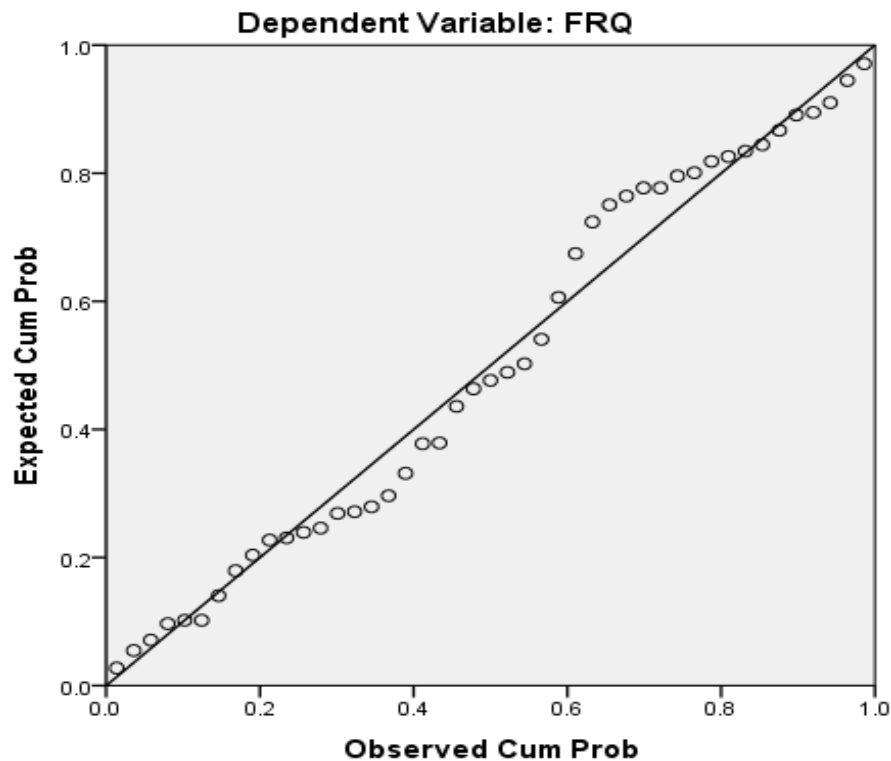


Figure 4.1 Test of Normality

Source: Researcher (2017)

4.2.4 Test of Multicollinearity

Using SPSS, the variance inflation factors(VIF) and tolerance values are computed where the values of VIF were less than 10 and tolerance were more than 0.1 according to the sample rule signaling absence of multicollinearity (Neter *et al.*,1996). The VIF values in table 4.5 were less than four meaning that there was no multicollinearity while for tolerance was above 0.2.

Table 4.5 Test of Multicollinearity

	Collinearity Statistics	
	Tolerance	VIF
(Constant)		
Board Size	0.735	1.36
Board Independence	0.912	1.096
Board meetings	0.721	1.387
Presence of audit committee	0.881	1.135
Firm Industry	0.62	1.612
Firm performance	0.83	1.205

Source: Researcher (2017)

4.2.5 Autocorrelation Test

A key assumption in regression is that the error terms are independent of each other. This section presents a simple test to determine whether there is autocorrelation or serial correlation. The Durbin-Watson test was used to test autocorrelation. Findings in table 4.8 show a Durbin-Watson 2.098 which is between 1.5-2.5 indicating minimal autocorrelation which does not influence the outcome of regression results. Hence, the assumption was met.

4.3 Correlation Statistics

Correlation analysis is a method of investigating the relationship between variables: board size, independence, meetings, audit committee, return on assets, and firm industry with the QFR. As such, the study examined the relationships that are inherent among the independent and dependent variables. Table 4.6 presents correlation results.

Findings revealed that board independence has a negative and significant relationship with the quality of financial reporting ($r = -0.542$, $p < 0.01$). Further, board meetings has a negative and

significant relationship with the QFR ($r = -0.343$, $p < 0.05$). Moreover, firm performance was positively correlated with the quality of financial reporting ($r = .392$, $p < 0.01$).

However, board size, audit committee and firm industry do not have significant relationship with the quality of financial reporting. This means that only board independence, board meetings and ROA are expected to influence the QFR.

Table 4.6 Correlation Statistics

	QFR	Board Size	Board Independence	Board meetings	Audit committee	Firm Performance	Firm Industry
QFR	1						
Board Size	0.172*	1					
Board Independence	-.542**	0.162	1				
Board meetings	-.343*	-0.014	0.124	1			
Audit committee	0.218*	-0.144	-0.084	0.113	1		
Firm Performance	.392**	-0.174	-.489**	-0.007	0.25	1	
Firm Industry	0.06	.465**	0.001	0.027	-0.029	0.216	1

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

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

Source: Researcher (2017)

4.4 Model 1: Effect of Control Variables (Firm performance and Firm Industry) on Quality of Financial Reporting

The findings on the control effect illustrate that firm performance and the firm industry explained 9.5 percent variation of quality of financial reporting. Since the value of R^2 were less than 75%

the study infer the model for control variable was not reliable. Table 4.7 present the results for control effect.

More findings showed that firm performance had significant and positive effect on QFR ($\beta = 0.322$, $p = 0.043 < 0.05$), while firm industry had no significant effect on QFR ($\beta = -0.055$, $p=0.723 > 0.05$). This infers that firms with higher firm performance are likely to increase their QFR. A summary of control effect presented in Table 4.7.

Table 4.7 Model 1: Effect of Control Variables (Firm Performance and Firm Industry) on Financial Reporting

	Unstandardized Coefficients		Standardized Coefficients			Collinearity Statistics	
	B	Std. Error	Beta	t	Sig.	Tolerance	VIF
(Constant)	-0.167	0.071		-2.368	0.022		
Firm industry	-0.004	0.012	-0.055	-0.356	0.723	0.886	1.128
Firm performance	0.098	0.047	0.322	2.088	0.043	0.886	1.128
R Square	0.095						
Adjusted R Square	0.053						
Std. Error of the Estimate	0.227						
Durbin-Watson	2.169						
F	2.248						
Sig.	.018b						

a Dependent Variable: QFR

Source: Researcher (2017)

4.5 Model 2: Effect of Control Variables (Firm performance and Firm Industry) and Independent Variable (Board Size, Independence, Meetings, Experience) on Financial Reporting

The R- squared result shows that a unit change of firm performance, board experience, independence, meetings, size and firm industry will lead to about 56 percent change in QFR (R squared =.56). This is complimented by the Adjusted R Squared of about 49.2 percent. In others words, board independence, meetings and size explains 56 percent variation in QFR. The significant value of the F- Statistics further justifies that the model is not biased. A summary is given in table 4.8.

Table 4.8 Model Summary

R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics				Sig. F Change	Durbin-Watson
				R Square Change	F Change	df1	df2		
0.748a	0.56	0.492	0.1661	0.56	8.259	6	39	0.000	2.098

a Predictors: (Constant), firm performance, board independence, meetings, board size, firm industry

b Dependent Variable: QFR

Source: Researcher (2017)

4.6 ANOVA Model (Testing Goodness of Fit)

The study used another method to test Goodness of fit of the model whereby none of the parameters is equal to zero. Study findings in table 4.9 indicated that there was goodness of fit and none of the parameters was equal to zero as evidence of F ratio of 8.964 with p value 0.000 <0.05. Thus, the model was fit to predict the quality of financial reporting using board size, board independence, board meetings and audit committee.

Table 4.9 ANOVA Model (Testing Goodness of Fit)

	Sum of Squares	Df	Mean Square	F	Sig.
Regression	1.367	6	0.228	8.259	.000b
Residual	1.076	39	0.028		
Total	2.443	45			

a Dependent Variable: QFR

b Predictors: (Constant), firm performance, experience, board independence, gender, board size, firm industry

Source: Researcher (2017)

4.7 Regression Analysis

Findings in table 4.10 showed that board size had coefficients of estimate which was significant based on $\beta_1 = 0.419$ (p-value = 0.002) thus board size has significant positive effect on the QFR. This suggests that there is up to 0.419-unit increase in the QFR for each unit increase in board size. The results imply that a larger board size is of essence. It can be deduced that a large board brings about efficiency in monitoring and control which in turn improves the QFR.

Research findings also showed that board independence had coefficients of estimate which was significant based on $\beta_2 = -0.502$ and p value less than 0.05 implying that board independence has a negative and significant effect on the quality of financial reporting. This indicates that for each unit increase in board independence, there is -0.502 units decrease in the QFR. Furthermore, the effect of board independence was stated by the t-test value = -3.982 which implies that the standard error associated with the parameter is less than the effect of the parameter.

As shown in table 4.10, p-value was less than 0.05, and the β_3 value of board meetings was negative ($\beta_3 = 0.310$). Therefore, the study concludes that board meetings has a negative and

significant effect on the quality of financial reporting. Consequently, for each unit increase in board meetings, there is 0.31 increase in the QFR. Table 4.10 further shows that audit committee has a positive and significant effect on the QFR basing on $\beta_4 = 0.253$ (p-value = 0.03 which is less than $\alpha = 0.05$). Therefore, the researcher concluded that AC has no significant effect on the QFR. The implication is that having an audit committee is of essence in enhancing the QFR.

Table 4.10 Summary of results

	Unstandardized Coefficients		Standardized Coefficients			Collinearity Statistics	
	B	Std. Error	Beta	t	Sig.	Tolerance	VIF
(Constant)	0.610	0.245		2.495	0.017		
Control Variables							
Firm Industry	0.025	0.032	0.1	0.77	0.446	0.666	1.503
Firm Performance	0.019	0.01	0.249	1.988	0.004	0.719	1.391
Independent Variables							
Board Size	0.029	0.009	0.419	3.382	0.002	0.734	1.362
Board Independence	-0.972	0.244	-0.502	-3.982	0.000	0.712	1.405
Board meetings	-0.053	0.018	-0.31	-2.866	0.007	0.968	1.033
Audit committee	0.117	0.052	0.253	2.246	0.030	0.888	1.126

Source: Researcher (2017)

CHAPTER FIVE

SUMMARY OF THE FINDINGS, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

The chapter highlights the summary of the findings, the results for the regression analysis for board size, independence, frequency of meetings, audit committee on quality of financial reporting, conclusion, recommendation and recommendation for further research for the concerned stakeholders and policy makers.

5.2 Summary of the findings

The primary aim of the study was to establish the relationship between board composition and quality of financial reporting among listed firms at the Nairobi Securities Exchange. To achieve the objectives of the study, secondary data was collected from 46 firms in the NSE. This section presents the findings from the study in comparison with what the extant literature has mentioned on the effect of board size, independence, frequency of meetings, audit committee on the quality of financial reporting as noted under literature review.

5.2.1 Board Size on Quality of Financial Reporting

The study established that the board size has a positive and significant effect on the QFR ($\beta_1 = 0.419$ $p < 0.05$) implying that having a large board improves the QFR. Consistent with the study findings, Abor, (2007) argues that a bigger board monitors managerial bodies and in that way, comes about a positive effect of board size on capital structure disclosure (Abor, 2007). Furthermore, Wen et al. (2002) posited that the board size influenced financial information disclosure. The authors argued that bigger boards might find it a challenge to reach an accord

thereby influencing the financial reporting. Similarly, Abor and Biekpe (2007) in their study on how the board composition affects the quality of financial reporting established that the board size has a negative effect on the level of reporting among firms. Moreover, Anderson *et al.*, (2004) noted that greater boards have low levels of implementing disclosure since such boards create pressure on directors to report more on gearing levels and enhance their performance.

5.2.2 Board Independence on Quality of Financial Reporting

Board independence has a negative and significant effect on the QFR ($\beta_2 = -0.502$ $p < 0.05$). However, Ameer *et al.* (2010) established that firms with external board members are depended upon to have a predominant quality financial reporting compared with those with majority of internal executives in the board. Also, Otchere, Bedi and Kwakye (2012) contend that the independent board is to be seen as the check and adjust technique to build the viability of the board. In support of the above notion, Zainal *et al.* (2009) revealed that a high degree of independent directors increases financial reporting quality mainly due to their experience variety, traits and ability. Additionally, Franks *et al.*, (2001) noted that independent directors give the basic checks to upgrade the operations of the board members hence diminishing conflicts among executives and financial specialists. On the contrary, Anderson *et al.* (2004) did not find a connection between the level of board independence and the quality of financial information.

5.2.3 Board Frequency of Meeting on Quality of Financial Reporting

The frequency of board meetings by the firms had a negative effect on the quality of financial reporting ($\beta_3 = -0.31$ $p < 0.05$). Contrary to the study findings, prior studies have established that the frequency of board meetings and the active participation of the members in such meetings

improves the QFR (Xie *et al.*, 2003; Vafeas, 1999). Further support to the study findings is by Ben Ayed-Koubaa (2010) who points out that the board meeting frequency can be considered as an antecedent of the quality of the financial information. The findings also concur with Oxelheim and Randoy (2003), that board members meetings have effect on firms' information disclosure. Additionally, Kerich (2006) established that the more board individuals meet, the higher the level of quality of financial reporting.

5.2.4 Audit Committee on Quality of Financial Reporting

The presence of an audit committee in the board had a positive and significant effect on the quality of financial reporting ($\beta_1 = 0.253$ $p < 0.05$). In line with the study findings, Klein (2002) confirmed that presence of audit committees increases the level of financial disclosure. Moreover, Beasley *et al.* (2000) revealed that presence of audit committees is in a general sense associated to disclosure quality, since financial report misrepresentation is significantly inclined to occur in firms without audit committee. In any case, extraordinary examinations found various results. However, Lin *et al.* (2006) uncovered irrelevant relationship between autonomous audit committees and wage repetitions. Similarly, Xie *et al.* (2003) demonstrated immaterial association between the level of optional accumulations and autonomous audit committee.

5.3 Conclusion

The study has established that the board size has a positive and significant effect on the quality of financial reporting. The findings indicated board with a high number of directors enhances the quality of financial reporting. Besides, with a larger board, the board has diversity of views, expertise and experience which brings about efficiency in monitoring and control.

The findings have shown that board independence has a significant negative effect on the QFR. The extant literature has shown that independent directors are at a better chance of ensuring that there is transparency and disclosure of accurate information. As such, a higher proportion of board independence enhances the quality of financial reporting. The results are however contrary to this notion. There is thus need for further research on the same to assess the validity of this concept.

The study established that the firms in the study meet at least twice in a year. It could be that the board meetings are not sufficient to enhance the quality of financial reporting of the firms. The above notion is on the premise that prior studies have established that the more firms meet, the higher the QFR. There is thus need for further studies on the same to fully ascertain the connection between the frequency of board meeting and quality of financial reporting.

Finally, having an audit committee is of essence for firms listed in the NSE. The experience and expertise brought about by the audit committee ensures that there is no financial misreporting. Concisely, having an audit committee means that the financial reporting process is effectively monitored. The resulting outcome is quality financial reporting by firms listed in NSE.

The above findings confirms with other studies such as Beasley et al. (2000) who argue that audit committees in the board have a positive and significant effect on the quality of financial reporting and Xie et al., (2003) who reported that board size has a positive and significant effect on the quality of financial reporting. Similarly Ayed-Koubaa (2010) confirms with our study that board independence has a negative and significant effect on the quality of financial reporting. This might due to the fact that most of these studies were conducted in listed firms and used same measurement and same sample size

5.4 Recommendations

Based on the study findings, increasing the number of board members influences the firms' QFR. Therefore, increasing the number of board members will increase the QFR. Further, there is need for a large board so that members of the board can distribute the workload and dedicate more of their time to monitoring. Larger boards are also of essence because of the diversity, expertise and experience it brings.

Furthermore, the study has found a negative relation between board independence and the quality of financial reporting. It is utmost necessary to have board independence as noted in the literature. There is therefore need for a further study that makes use of a larger data set to assess whether the negative relation between number of non-executive directors and the QFR is valid.

The findings of the study have shown that board meeting have a negative effect on the quality of financial reporting. There is therefore need for firms listed in NSE to have at least for meeting in a year. With such meetings, the firms can be able to enhance monitoring and control of their financial process and thereby impacting positively in the quality of financial reporting.

Finally, the study found a positive and significant effect of audit committee on the quality of financial reporting. It is therefore important for firms to have an audit committee so as to improve the quality of financial reporting. Besides, having an audit committee makes it possible for firms to evaluate the firm's financial statements, the process of audit and internal accounting controls to prevent earning management from being practiced by management.

5.5 Limitation of the Study

The study however, faced some limitations which are detailed below;

1. The study was limited to four board composition components which are board size, board independence, board meetings and audit committee
2. The study was also restricted to firms listed in Nairobi security exchange only.
3. Data collected was limited to secondary sources only.

5.6 Suggestions for Further Research

This study was conducted to establish the relationship between board composition and quality of financial reporting among listed firms at the Nairobi Securities Exchange. The sample was drawn from only firms listed in the Nairobi Securities exchange, thus this study may be limited in its inference and generalization of the results. Thus, future research should have to draw sample of respondents on a larger sample for the sake of generalizing the findings of the study.

Furthermore, data was based on secondary sources only therefore there is need for combination of more than one data sources for example there is need to collect data from both secondary and primary sources to enrich the study findings.

Based on the fact that the study only used four board composition a further study is needed to be carried out using more variables that may be appropriate to this study such as board gender, board age, board financial experience.

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APPENDIX

APPENDIX I: DOCUMENT ANALYSIS GUIDE

FOR THE YEAR 2015

Name of NSE Firm		board Size	board Independence	Boar d fre qu ency meeti ngs	Audit committee	QFR=Change(CA-C- CL+SDT- DEP)/av total assets					QUALITY OF FINANCIAL REPORTING
No.	Name		<i>Ratio of Non- exucutive:size of board of directors</i>	<i>M</i>		<i>CA</i>	<i>C</i>	<i>C L</i>	<i>SD T</i>	<i>DE P</i>	<i>(CA-C- CL+SDT- DEP)/total assets</i>
1											
2											
3											
4											
5											
6											
7											
8											

Source: Researcher (2017)