

**THE ROLE OF THE AUDIT COMMITTEE IN THE CORPORATE  
GOVERNANCE OF STATE CORPORATIONS: A CASE OF THE  
KENYA URBAN ROADS AUTHORITY**

**BY**

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## **DEDICATION**

To my dear parents Mr. and Mrs. Danson Githinji who have encouraged me to continuously improve my education.

To my loving wife Mary Nyambura and our children Danson, Muthoni and Nyokabi for their unwavering support as I pursued this degree.

You all know how much I appreciate your support.

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# CHAPTER ONE

## INTRODUCTION

### 1.1 Background to the Study

State Owned Enterprises (SOEs) commonly known as government Parastatals were first established in Kenya by the colonial government, these were meant to provide essential services to the white settlers. Indigenous Africans participation in economic activities such as trade and cash crop farming was, generally, discouraged. (CGD, 2002) After independence in 1963, the independent Kenya government devised strategies to achieve three goals; that were considered imperative for development and growth: to speed up overall economic growth rate, provide equitable distribution of development benefits and for the 'Kenyanization' of the economy. The means of achieving these goals were clearly defined in Sessional Paper No. 10 of 1965 on African Socialism and its Application to Planning in Kenya, which states that, "under African Socialism, the power to control resource use resides with the state". (CGD, 2002)

State Owned Enterprises (SOEs), or parastatals, are businesses that are owned and managed by the government. Beginning 1965 onwards, the government actively expanded and strengthened SOEs as the vehicles of development and Kenyanization. Indeed, as the SOEs proliferated in the first decade of independence, Kenya's economy grew apace at an impressive rate of 6.8%. Economic growth, however, dropped marginally to 5% in the 1980s, and further declined to a mere 0.3% in 1990s. (CGD, 2002)

The Kenya government forms parastatals to meet both commercial and social goals. Some SOEs exist to correct for market failure. This is the case, where, for instance, the service they give cannot be profitably provided by the private investors. By 1990, the Kenya government held equity in 250 commercial enterprises and had majority shareholdings in more than half of the 250 enterprises. Of these, the government directly held equity in about 50 enterprises while government-owned development finance institutions held equity in the rest. (CGD, 2002). The management of these parastatals and other state owned corporations and government owned institutions is therefore very critical to the overall economic development

of the country. It is in this regard that corporate governance as exercised on these state owned enterprises is important.

Corporate Governance is concerned with the establishment of an appropriate legal, economic and institutional environment that facilitates and allows business enterprises to grow, thrive and survive as institutions for maximizing shareholder value while being conscious of and providing for the well being of all other stake holders and society. It is a system by which corporations are directed, controlled and held to account. In this regard, the role of the Board is to ensure that a corporation is directed, controlled and held to account.

The State should put in place and maintain an enabling environment in which efficient and well managed companies can thrive. It is the responsibility of the owners of the corporation to elect competent directors and to ensure that they govern the corporation in a manner consistent with their stewardship. Good corporate governance dictates that the Board of Directors governs the corporation in a way that maximizes shareholder value and in the best interest of society.

According to the Institute of Internal Auditors (IIA), *"Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance process.* The Sarbanes-Oxley Act (SOA) (Sect. 301) strengthens prior professional and regulatory pronouncements related to creating a strong Board Audit Committee. The members must not be part of management and include one financial accounting expert. Through its professional standards (Attribute Standard 1110) and practices, the IIA has been a strong advocate for the internal audit group to report (functionally) to the Board Audit Committee.

## **1.2 Statement of the Problem**

The necessity for Good Corporate Governance and accountability by corporate managers has overwhelmingly increased today in the wake of widespread fraud, corruption, misappropriation of funds and mismanagement of corporations especially in state managed corporations. The large number of complaints and disgruntlement bears testimony against the performance of state run institutions as filed at the office of the Ombudsman as well as highlighted from time to time by the press. Complaints have also been filed at the parent Ministries, with the Kenya Anti Corruption Commission and even tabled by members of parliament at the floor of the house. This has led to heightened need for state corporations to adopt good Corporate Governance and accounting practices in their organizations.

The problem of state corporations indicates that the impacts of the state corporations have largely been negative given that politicization and poor corporate governance, weak supervisory mechanisms and structure of financing and financial management have been features in the poor management of these corporations. Though Governments, private sector and regulatory bodies have since come up with numerous legislations to help regularize organizations to minimize cases of corporate governance fraud and mismanagement, these have still been witnessed . There is need for firms and government agencies to adhere to Good Corporate Governance through prudent financial management practices, the development of quality and safe products and services, care for the environment and good corporate governance responsibility, and compliance with set legislations that govern the management of corporate organizations.

The Audit Committee is a key fulcrum in any corporate organization in monitoring and placing a check on good accounting and management practices. The Audit Committee function of an organization plays a significant role in enhancing good corporate governance by providing an assurance of adherence by management to observe prudent corporate policies, the management of risks and place a check on internal controls compliance with set auditing standards. The Audit Committee can be of great help to the board in establishing, implementing, monitoring, evaluating and sustaining good corporate governance practices for the benefit of the company and its stakeholders.

## **1J Purpose of the Study**

This study is carried out with a view to informing policy as well as legislative decisions in good corporate governance of state run enterprises with an aim of increasing their performance and a focus on the essence of the Audit Committee's role in the management of parastatals.

## **1.4 Objectives of the Study**

The main objective of the study is to determine the effectiveness of an organization's Audit Committee in enhancing good corporate governance and accountability. The study will assess the role of the Audit Committee of state corporations in Kenya with a focus on KURA.

The specific research objectives will include:

1. To determine the effect of training of the Audit Committee members on the improvement of corporate governance in KURA.
2. To assess whether the composition of the Audit Committee members affects good corporate governance in KURA
3. To determine the effect of regular meetings of the Audit Committee members on good corporate governance in KURA.

## **1.5 Research questions**

In order to achieve the above stated objectives, the following research questions will guide this study: -

1. What is the effect of training of the Audit Committee members in improving good corporate governance in KURA?
2. How does the composition of the Audit Committee members improve good corporate governance in KURA?
3. What is the effect of regular meetings on good corporate governance in KURA?

## **1.6 Significance of the Study**

This research will provide useful information for the Government and KURA on the status of Audit Committees in corporate institutions. The government and parastatals will benefit through understanding of the role played by the Audit Committee in enhancing their corporate governance practices and accountability. The research will make suggestions on ways of strengthening and improving the internal audit committee so as to enhance their performance through reduction of corporate malpractices.

Other government institutions and the private sector will benefit through the understanding of corporate governance practices and the important role that the Audit Committee plays in enhancing corporate governance, particularly in fostering corporate accountability and transparency. The managements of different business organizations will benefit from the study through the understanding of the role of the Audit Committee in state run corporations in enhancing good corporate governance practices. They will also be in a position to institute stringent audit practices and timely act on cases of corporate malpractices. The board will learn of the important role the audit committee has in safeguarding the public funds and the interest of other stakeholders in their watchdog role.

## **1.7 Delimitation of the Study**

The study will investigate the role and function of the audit committee in KURA examining its successes and failures. The study will limit itself to the analysis of the internal audit practices carried out within the KURA to determine whether they enhance or compromise corporate governance and financial accounting standards required by corporate institutions in Kenya.

The results that will be obtained out of this study may generally apply to other state corporations and state run enterprises. The study target interview will consist of the finance department of the institution as well as the audit committee of KURA. Data collected will be analyzed both qualitatively and quantitatively as appropriate. Descriptive statistics will be used to analyze data. Quantitative data will be used to analyze data in terms of frequency

distribution tables and percentages. To ensure easy data analysis, questionnaires will be coded numerically with a coding scheme for each variable of study. This means that each variable will be assigned an exclusive code. This eliminates errors and increases accuracy level of the results. Data will be analyzed using the **SPSS** programme to group data because the programme has the capability to handle recurring needs of data analysis. **MS Excel** will be used to produce graphs and summarized frequency table.

To ensure data validity, quality and reliability the same data will be collected each time over repeated tests/ observations during the pre-test of tools. To assure reliability questions will be precisely worded and the coding will be consistent particularly with open-ended questions. There will be proper definition of key terms. Data validity will factor in the face, internal and external validation aspects and ensure a measure that accurately reflects the concept it is intended to measure.

### **1.8 Limitation of the Study**

The likely challenge is the unwillingness to cooperate by some of the staff of the parastatal. This will be overcome by assurances of utmost confidentiality of this study

### **1.9 Assumptions of the Study**

There are no assumptions in this study. The study has been deliberately designed to avoid subjective measurement, proxy indicators, errors in measurement or and non-cooperation of respondents among others

### **1.10 Definition of Significant Terms**

**Audit Committee** - an operating committee of the Board of Directors charged with oversight of financial reporting and disclosure.

**Corporate Governance** - refers broadly to the rules, processes, or laws by which corporations, organizations or businesses are operated, regulated, and controlled.

**Paranatal** - a quasi-governmental organization, corporation, business, or agency. Owned or controlled wholly or partly by the government

**Ranking of Organizations** - is a competitive assessment for rating an organization relative to its peers in the industry.

**State Corporation** - legal entity created by a government to undertake commercial activities on behalf of an owner government

### **1.11 Organization of the study**

The research study has been organized and arranged in the following main sections for clarity sequence and ease of compilation.

The Introduction - This section covers the background to the study, statement of the problem, the purpose and the objectives of the study, the research questions, the significance of the study, the limitations and delimitations to the study, the assumptions to the study, the definition of terms and the summary of the chapter one.

Literature Review - This section reviews literature looking at the Role of the Audit committee, the audit standards adopted by the state corporations, the role of the board in enhancing internal audit practices, the rate of compliance by state corporations to the audit practices, the independence of the audit committee it also incorporates the conceptual framework of the study and ends with a summary to the chapter

Methodology - This section looks at the introduction of the method used, research design, target population, sampling procedure, design and sample size. The method of collecting data, the research procedure, validity and reliability, the methods of data analysis and presentation winding up with a summary to the chapter.

References

Appendices to the study paper

## **1.12 Summary**

This study seeks to enhance overall understanding of corporate governance in government owned corporations. This will be extremely important as government owed corporations contribute a significant amount of Gross National Product of the country.

# **CHAPTER TWO**

## **LITERATURE REVIEW**

### **2.1 Introduction**

The reflection and the collation of the literature review to this chapter attempts to present a review of various previous studies that have been undertaken in relation to the role of the audit committee in good corporate governance. Various studies and academic work on this subject are reviewed herein to provide a broad perspective on the role of the audit committee in practicing good corporate governance and specifically with a directed view on its role, functions and effectiveness as regards the audit committee's of state corporations. This study will delve into the review of literature that deals majorly with the conduct and performance of the audit committees in state corporations. The corporate governance players have a common objective in ensuring financial reporting quality. The audit committees are responsible for hiring and overseeing external auditors' work ( Sox 2002), which gives them great authority over audit quality. When these responsibilities are taken into consideration as a whole, audit quality can be considered to have an effect on the relationship between audit committee effectiveness and financial reporting quality.

The study will make an overview at the role of the audit committee in enhancing good corporate governance and accountability in state corporations, the particular audit standards that have been adopted by state corporations to enhance corporate governance, the role and the performance of the board in enhancing prudent internal audit practices and good corporate governance in state corporations, the rate of compliance by state corporations in establishing proper regulatory audit practices and prudential financial guidelines in the administration and management of the state corporations, the independence of the internal audit committees of state corporations from interference in their audit operations and the limits set by state corporations for particular actions to be taken to guard against reported cases of malpractices within these corporate institutions.

This review will enable the study to assess and determine the value and the effectiveness of the role played by the audit committees in state corporations to enhance good corporate governance and to ensure transparent and accountable management of state corporations.

The Kenyan government acknowledges that over the years there has been poor performance in the public sector, especially in the management of public resources which has hindered the realization of sustainable economic growth (GoK, 2005). The Kenya government initiated the formation of state corporations to meet both commercial and social goals. They existed for various reasons which include: to correct market failure, to exploit social and political objectives, to provide education, health, to redistribute income or develop marginal areas. At independence in 1963, state corporations or parastatals were retooled by the sessional paper no. 10 of 1965 into vehicles for the indigenization of the economy and africanization of the nation. (Njiru, 2008).

Corporatism is the theory and practice of organizing society into "corporations" subordinate to the state. According to corporatist theory, workers and employers would be organized into industrial and professional corporations serving as organs of political representation and controlling to a large extent the persons and activities within their jurisdiction. (Njiru, 2008)

Corporatization on the other hand refers to the construction of state corporatism, where government-owned corporations are created and then delegated public social tasks resembling corporate nationalism, away from autonomous privatization. Corporatization can also refer to non-corporate entities like universities or hospitals taking up management structures or other features and behaviours employed by corporations. (Njiru, 2008)

State corporations have become a strong entity in Kenya and very useful engines for promoting development. Kenya's Vision 2030 is the new country's development blueprint covering the period 2008 to 2030. It aims at making Kenya a newly industrialized, "middle income country providing high quality life for all its citizens by the year 2030". The Vision has been developed through an all-inclusive stakeholder consultative process, involving Kenyans from different walks of life and from all parts of the country. The vision is based on three "pillars" namely; the economic pillar, the social pillar and the political pillar. This vision's programme plan comes after the successful implementation of the Economic Recovery Strategy for Wealth and Employment Creation (ERS) which has seen the

country's economy back on the path to rapid growth since 2002, when GDP was at 0.6% rising to 6.1% in 2006. (Njiru, 2008; Cabinet Office, 2007; Omano, 2005)

The economic pillar aims at providing prosperity of all Kenyans through an economic development programme aimed at achieving an average Gross Domestic Product (GDP) growth rate of 10 % per annum the next 25 years. The social pillar seeks to build "a just and cohesive society with social equity in a clean and secure environment". The political pillar aims at realizing a democratic political system founded on issue-based politics that respects the rule of law, and protects the rights and freedoms of every individual in the Kenyan society. (Njiru, 2008; Cabinet Office, 2007; Omano, 2005)

The problem of state corporations indicates that the impacts of the state corporations have largely been negative, some of the reasons for this include:

Politicization and poor corporate governance - boards of parastatals are appointed by political powers (the president and the minister) as are the chief executives. Thus many operational decisions are not necessarily non partisan. Weak supervisory mechanism - the role of the state corporation advisory committee is just advisory yet it could play a more powerful as a monitor and evaluator of performance of state corporations. The structure of financing and financial management - many state corporations are allocated funds through line ministries and thus end up being chronically underfunded whereas the role of the audit committee remains unclear in many state corporations as they are also duly politically guided. The corporations are allowed to borrow funds but many have not repaid the loans borrowed. Expenditure controls are terribly weak. Prosecution of chief executives for abuse of office and misappropriation of funds is usually not carried out effectively. (Njiru, 2010; Karugor, 2005)

The need for corporate governance practices by State Corporations is a response to the growing importance of governance issues both in the emerging and developing economies and for promoting efficient utilization of public resources. It is also in recognition of the role of good governance in management of public corporate finance, capital formation and maximization of shareholders value as well as protection of investors' rights.

Corporate Governance is also concerned with creating a balance between economic and social goals as well as individual and communal goals while encouraging efficient use of resources, accountability in the use of power and stewardship and as far as possible to align the interests of individuals, corporations and society.

The Ministry of Finance has developed guidelines for good corporate governance practices in response to growing importance of governance issues in Kenya particularly in government institutions. The guidelines states that "good corporate governance practices must be nurtured and encouraged to evolve as a matter of best practice but certain aspects of operation in a body corporate must of necessity require minimum standards of good governance"

According to Ole Nkeri (2003) corporate governance is not merely about rules, board committees and controls but about creating performing organizations that consistently succeed in the market place against competition.

## 2.2 The Role of Audit Committee in enhancing corporate governance in state corporations

The Institute of Internal Auditors (IIA November, 2003) names the Audit Committee function as one of the four corner stones of good governance alongside the board, executive management and external audit. It notes that with the right positioning in an organization and with professional staff and leadership, an audit committee function will provide independent and objective opinions on the organization's operations and report these regularly to the board and management. (IIA, 2003)

The Audit Committee acts as a control mechanism over senior management by ensuring adequate internal controls', reviewing the reliability of records, enforcing board decisions, undertaking statutory duties where they exist, receiving reports on detection and prevention of fraud, causing the undertaking value for money audit exercises, causing the undertaking of assignments as directed by the board e.g. overseeing the implementation of external requirements and monitoring the reporting procedures. (IIA, 2003)

The Audit Committees are now being challenged by other committees and the chief executives to not only prove their value but to play a larger role in Corporate Governance. The Audit Committee has a significant role to play in a company's demonstration of good Corporate Governance and that an effective Audit Committee function embraces a broad concept of risk assessment and management focusing on monitoring financial and operational controls and compliance. (Hespenheide, 2003)

According to Woda (2002), the auditor who is a key pillar in the Audit Committee is a strong supporter and catalyst for helping organizations establish governance in financial management, regulatory compliance, operational management and information technology (IT). He notes that it is now more important for auditors to become more involved in supporting and helping implement Corporate Governance in IT and management. He notes that IT and Corporate Governance are concerned with communication and internal checks and balances.

Hamaker (2003), notes that the recent spate of high profile corporate bankruptcies has intensified the call for improved corporate governance. He has defined three forms of corporate governance: The first form is Corporate Governance, which is a concept that developed during the 1990s and proposed by Organisation for Economic Cooperation and Development (OECD). It states that, the corporate charter defines the corporate governance structure of an organisation, by laws and formal policy.

The second form of governance is enterprise governance, which is a relatively new informal term that refers comprehensively to the way an organisation is managed. It is the set of responsibilities and practices exercised by the board and executive management with the goal of providing strategic direction, ensuring that objectives are achieved, ascertaining that risks are managed appropriately and verifying that the enterprises resources are used responsibly.

The last form of governance is the information technology governance, which consists of the leadership and organisational structures, and processes that ensure that the organisation

information technology sustains and extends the organisations strategies and objectives. The purpose of good corporate governance is to ensure integrity of accounting and financial reporting systems that include independent audit that have appropriate financial controls, risk monitoring, and compliance with laws and regulations.

### 2.3 The audit standards adopted by state corporations to enhance corporate governance and accountability

Hynes (2010), notes that the Kenyan government is trying to improve ethics and governance in public and private enterprises in an effort to attract foreign direct investment (FDI). Kenya is a major economy in the east and central African region, and its success in improving economic performance is likely to have a significant demonstration effect on the region's economic development. (World Bank, 2001)

Although the country has taken some measures to improve its economic governance, economic growth and various social indicators continue to decline. This is partly a reflection of how deeply entrenched many problems are, including in the area of financial accountability in both private and public sectors. Deep-seated skepticism on the part of private investors, specifically foreign private investors, about the possibility of successfully implementing reform initiatives has not yet been overcome, and private investment levels remain very low. (World Bank, 2001).

Weaknesses in corporate governance practices, lack of pressure from the users of financial statements for high-quality information, and the general absence of transparency in the corporate sector, pervade the corporate financial reporting regime in Kenya. (World Bank, 2001) The fact that a number of banks failed in the late 1990s, and the audited financial statements did not provide early warning signals about these failures, has raised concerns among the general public about the quality of accounting and auditing in the country. (World Bank, 2001)

Effective and efficient management of public sector organizations and institutions is an issue of public concern in many countries. Melese et al. (2004) argue that public sector

organizations are increasingly being demanded to be more accountable for their performance and are therefore expected to operate efficiently and effectively. This therefore implies that public sector organizations and the management have to search for ways and means to improve on their activities and performance. Notable approaches which may be applied include the use of performance contracts. Similarly, activity based management practices in corporate institutions can increase transparency and efficiency when conducting government activities thereby assisting public sector organizations to achieve their objectives (Baird, 2007; Melese et al., 2004; Mulili, 2011)

Rwegasira, (2000) argues that the concept of corporate governance is not necessarily the best solution for the developing economies. This is because a number of developing countries face numerous problems that include unstable political regimes, low per capita incomes and diseases. Such problems require more elaborate solutions than simply adopting corporate governance concepts. (Mulili, 2011; Okeahalam, 2004; Shleifer and Vishny, 1997).

Tsamenyi, Enniful-Adu and Onumah (2007) argue that developing countries are often faced with a multitude of problems that include uncertain economies, weak legal controls, protection of investors and frequent government intervention. These problems make it even more necessary for developing countries to adopt effective corporate governance structures. The pressures of an increasingly globalized world economy, democratization, IMF/World Bank's economic reforms and the recent financial scandals in the West have forced a number of developing countries to adopt the corporate governance ideals (Aliunwan, 2002; Gugler, Mueller & Burcin, 2003; Reed, 2002). It has also been suggested that improved corporate governance systems can serve as an incentive for attracting foreign investment (Aliunwan, 2002). In fact, it is poor economic performance and high international debt levels in emerging markets that forced the World Bank, IMF, and the IFC to intervene in an effort to improve the corporate governance systems of these markets (Reed, 2002; Mulili, 2011).

Although in practice companies use the standards adopted by the ICPAK, it is not legally authorized to issue accounting and auditing standards. As far as enforcement of legal requirements is concerned, the UNCTAD pointed out that in practice the levels of non-compliance with IFRSs are quite high. (World Bank, 2001; ICPAK, 2008) In addition, UNCTAD reported that some industry specific regulation in Kenya and IFRS-based requirements are not compatible and thus universal adherence to IFRSs has not been achieved. In response, the ICPAK stated in a 2008 Action Plan prepared for the IFAC that it is in the process of reviewing the financial reporting environment to identify existing and potential hindrances to the adoption and implementation of IFRSs. (World Bank, 2001; ICPAK, 2008)

The audit function in State Corporation is by legal statutes bestowed upon the Kenya National Audit Office (KENAO) which is mandated through Section 29(i) of the Public Audit Act 2003, to carry out audits on economy, efficiency and effectiveness with which the government, a state corporation or a Local Authority uses its resources. Environmental Audit falls under this section since it seeks to establish the three E's (economy, efficiency and effectiveness) in respect to environmental issues. In this regard, KENAO will seek to ensure improved and sustainable benefits to environment in use of available resources. (KENAO, 2012)

The Kenya National Audit Office (KENAO) is a Constitutional office mandated to audit the Central Government, Local Authorities and State Corporations. Originally this Office was referred to as the Exchequer & Audit Department which with time changed to be the Office of the Controller and Auditor-General. During this period, the Office derived its mandate from the Exchequer and Audit Act: Cap 412, which provided for the audit of the Central Government by the Controller and Auditor General. Later the Act was amended to provide for audit of Local Authorities and State Corporations.

On July 1, 1977, the Accountants Act, Chapter 531, Laws of Kenya, established three bodies: (i) Institute of Certified Public Accountants of Kenya (ICPAK); (ii) Registration of Accountants Board (RAB); and (iii) Kenya Accountants and Secretaries National Examinations Board (KASNEB). The KASNEB administers examinations for persons

intending to qualify for registration as accountants and company secretaries; the bulk of its student membership comprises those pursuing accountancy either at the technician level or as full certified public accountants (CPAs). (World Bank, 2001). The RAB is empowered to register those who have attained the specified qualifications after passing the relevant examinations administered by KASNEB. Persons holding designated foreign accountancy qualifications are allowed to be registered with the RAB after passing the examinations in company law and taxation administered by KASNEB. (World Bank, 2001). Upon completion of examination requirements, when a person obtains CPA registration with the RAB, he/she is allowed to be a member of the ICPAK. Recommendations for review of the Accountants Act to address institutional weaknesses have already been presented to the Ministry of Finance, and a draft revised law has been forwarded to the Treasury. (World Bank, 2001)

The existing statutory framework poses challenges to efforts to strengthen the accounting profession. The arrangement for regulating the profession through three separate entities has given rise to coordination problems in mobilizing resources to improve the quality of professional education and training and to enforce rules, regulations, and standards. (World Bank, 2001). A Committee established by the Treasury has been entrusted with the responsibility to find ways to improve coordination among the three separate bodies involved in the process of examination, registration, and membership. It is perceived that the outcome of this process should help overcome constraints to effective decisions that impact the whole spectrum of accounting profession. The ICPAK and KASNEB are already addressing matters concerning the strengthening of the CPA qualification process. A market perception survey is in progress which will identify needs in addition to benchmarking the qualification to internationally accepted requirements. (World Bank, 2001)

The Companies Act requires all limited liability companies to prepare and present annual audited financial statements. The Kenyan Companies Act, which is substantially the same as the U.K. Companies Act of 1948, was not amended to reflect the requirements set by the Accountants Act. Consequently, there is lack of clarity concerning the statutory

requirements on disclosures in the financial statements of limited liability companies. (World Bank, 2001)

### **2.3.1 Efficiency Monitoring Unit**

The work of the Efficiency Monitoring Unit entails continuous monitoring and analyzing of Government Policies, Programmes and Projects with a view to advising the Government on problems being encountered in their implementation and recommending remedial measures, reviewing existing management systems, procedures and practices of public sector organizations with a view to improving their effectiveness and efficiency; studying implemented projects and drawing practical experiences for future use. In planning and designing of similar projects; assessing sustainability of completed development projects; monitoring working environment in the public sector and the conditions of public offices with a view to making appropriate recommendations' for improvement.

### **2.4 The role of the board in enhancing prudent internal audit practices and good corporate governance**

According to Kajola (2008), corporate governance provides for the roles of the board or corporate management as being: The business of a firm is managed under the direction of a board of directors who delegates to the CEO and other management staff, the day to day management of the affairs of the firm. The board sees to the appointment of a qualified person as the CEO and other management staff. The directors, with their wealth of experience, provide leadership and direct the affairs of the business/institution with high sense of integrity, commitment to the firm, its business plans and long- term shareholder value. The board provides other oversight functions.

Under Section 2 of the State Corporation Act, a Board is defined as: - "... the body or person, by whatever name called, carrying out or empowered to carry out functions relating to the overall direction and management of a State Corporation". (Tanui, 2009) Further, Section 15 of the State Corporation Act, Cap 446 stipulates that: - "A Board shall be responsible for the proper management of the affairs of a State Corporation and shall be accountable for the moneys, the financial business and the management of a State

Corporation". (Tanui, 2009). Every Corporation should be headed by an effective Board that should exercise leadership, enterprise, integrity and judgment in directing the corporation so as to achieve continuing prosperity and to act in the best interest of the enterprise in a manner based on transparency, accountability and responsibility. As can be noted from the above, Corporate Governance framework in state-owned enterprises is very complex. The respective powers, roles and responsibilities of Parliament, Ministers, Boards and Chief Executive Officers tend to result in greater management complexity in terms of stewardship and accountability than is the norm in the private sector. (Tanui, 2009)

There are several ways in which corporate governance helps companies and economies attract investment and strengthen the foundation for long-term economic performance and competitiveness. First, by demanding transparency in corporate transactions, in accounting and auditing procedures, in purchasing, and in all of the myriad individual business transactions, corporate governance attacks the supply side of the corruption relationship. Corruption drains companies' resources and erodes competitiveness, driving away investors. (La Porta, De Silanes, Shleifer, & Vishny, 1997) Second, corporate governance procedures improve the management of the firm by helping firm managers and boards develop a sound company strategy, and by ensuring that mergers and acquisitions are undertaken for sound business reasons, and that compensation systems reflect performance. These measures help companies to attract investment on favorable terms and enhance firm performance. (La Porta, De Silanes, Shleifer, & Vishny, 1997)

Third, by adopting standards for transparency in dealing with investors and creditors, a strong system of corporate governance helps to prevent systemic banking crises, even in countries where most firms are not actively traded on stock markets. Taking the next step and adopting bankruptcy procedures also helps to ensure that there are methods for dealing with business failures that are fair to all stakeholders, including workers, owners, and creditors. Without adequate bankruptcy procedures, including enforcement systems, there is little to prevent insiders from stripping the remaining value from an insolvent firm to their

own benefit. This has happened on a wide scale during many of the privatization efforts in transitional and emerging markets, with disastrous results.

(La Porta, De Silanes, Shleifer, & Vishny, 1997)

Fourth, recent research has shown that countries with stronger corporate governance protections for minority shareholders also have much larger and more liquid capital markets. Comparisons of countries that base their laws on different legal traditions show that those with weak systems tend to result in most companies being controlled by dominant investors rather than a widely dispersed ownership structure. Hence, for countries that are trying to attract small investors - whether domestic or foreign - corporate governance matters a great deal in getting the hard currency out of potential investors' mattresses and floorboards. Collectively, these investors may be a significant source of large sums of long-term investment. (La Porta, De Silanes, Shleifer, & Vishny, 1997)

A good board assures the corporation's investors that the assets they've provided are used by the corporate managers - heir agents - to further corporate conduct aimed at achieving the corporate purpose to which they've agreed, and thereby achieving value for the investors. It assures them that their capital is not being wasted or misused, but is being used to promote corporate economic performance, that in turn promotes corporate value and social well-being generally. (CIPE, 2003). Specifically, and turning to solid economic theory, an independent board reduces the losses from the "agency" problem, fundamental to the public corporation, that is inherent in the separation of ownership from control. By monitoring the agents (the managers) good boards assure good economic performance; good governance and performance result in lower capital costs and higher shareholder values. Boards can be most effective in their oversight role when their members are sufficiently independently minded to monitor the managers, and to treat all shareholders fairly. (CIPE, 2003)

Contestability is a factor in keeping management focused on performance, the mechanism that empowers those better suited to a task to take it over from those less capable. Simply, if management does not perform, it should be removed by the board. And the law should

provide shareholders with the ability to replace both the board and management through a sale to a third party. In short the threat of a takeover should be present, as a spur to performance. (CIPE, 2003). The result is that management doesn't stagnate for long: if nonperforming managers are not replaced (usually by being encouraged by the board to quietly step down) the market for corporate control may step in by removing the board. When corporate governance systems provide managerial oversight and contestability, it is more likely that managers and boards who do not focus on improving firm performance and on putting assets to efficient use will be replaced. (CIPE, 2003)

### **2.5 The rate of compliance to established regulatory audit practices and prudential financial guidelines**

According to Awoyemi, (2009), that in a practically globalised market place such as we have today, the tendency for governments to move towards increased regulation is high, yet this has a high possibility of titling towards protectionism. Indeed the role of government in business has been shown to have a direct link to corrupt practices as the exercise of political ciout leads to favours for cronies and political associates which tendencies make the case against government role more compelling. Yet, it is undeniable, as evidence suggest, that leaving firms to self regulate is a stretch of responsibility taken too far. This is because the natural human instinct for self preservation, survival and to get ahead of everyone often places firms in direct conflict with the wider expectations of a corporate governance regime.

Kenya has made significant strides in putting in place the institutional framework for improving corporate accounting, auditing, and financial reporting practices since the first time of the ROSC Accounting and Auditing review exercise conducted in 2001. (World Bank, 2010). The framework appears to be of higher quality than that of the one in 2001. However, there is room for improvement. Moreover, in order to face future challenges, updating of the institutional underpinnings of accounting and auditing, in line with international developments of good practices, would allow Kenya to emerge as a role model of accountancy reform and development both regionally and internationally. (World Bank, 2010)

Article 110 of the Kenyan Constitution empowers the Kenya National Audit Office (KENAO) to undertake audits of state-owned enterprises. The KENAO audit work primarily focuses on compliance with financial management rules set by the Government. Its audit of state-owned enterprises focuses on evaluation of fiscal plans implemented, reviews of income and expenses, and assurance of compliance with state's financial and economic guidelines. KENAO has the authority to appoint statutory auditors to undertake the audit works on behalf of the Controller and Auditor General and, in such cases, the audit opinion is signed by the Controller and Auditor General. (World Bank, 2010). In recent years, Kenya's legislative and regulatory regime, applicable to accounting and auditing of corporate entities, banks, and similar financial institutions, has changed significantly. In 2008, a new Accountants Act was promulgated. The Government is in the process of issuing a new Companies Act. Furthermore, many regulator)' pronouncements were made with the objective of putting in place a sound institutional framework for regulating accounting, auditing, and corporate financial reporting. (World Bank, 2010)

The State Corporations Act: as in many other African economies. State-owned corporations play a significant role in Kenya. Owing to the plethora of State corporations subject to different legislative regimes, the State corporations Act was enacted to streamline the operations of State Corporations. (UNCTAD, 2003). For this reason, it is a statute of general application and specifically provides that in the event of conflict between its provisions and those of other statutes, including the Companies Act under which some state corporations are enacted, the State Corporations Act prevails. In terms of disclosure requirements, the provisions of the State Corporations Act do not differ materially from those of the Companies Act. However, the statute confers significant powers on the Executive and particularly the President, the Responsible Minister, the Treasury and the Permanent Secretary of the parent ministry, who is the accounting officer. (UNCTAD, 2003)

The narrow definition of governance relates to the avoidance of corruption which is a difficult but undoubtedly very important issue. The concern with corruption is neither new in India nor unique to her, a similar verdict can be spoken of Kenya as well. It is obviously

impossible to quantify the extent of corruption in India on any reliable basis and even more difficult to compare the situation across countries. (Ahluwalia, 1997). In 1996 India was ranked ninth on a list of 54 countries in descending order of perceived corruption. Nigeria topped the list followed by Pakistan, Kenya, Bangladesh, China, Cameroon, Venezuela and Russia. (Ahluwalia, 1997) A similar situation can be visualized as being experienced in the Kenyan case as relates to public institutions in general and to the state corporations in particular.

## 2.6 The Audit Committees of state corporations independence from interference in their auditing operations

Good public management and administration, with emphasis on accountability and responsiveness to customer needs, has been seen as an aspect of good governance by donor agencies supporting reforms in developing countries. To the World Bank, good governance consists of a public service that is efficient, a judicial system that is reliable, and an administration that is accountable to the public. The World Bank elaborates on four elements of good governance (World Bank, 1989, 1992):

Public sector management emphasizing the need for effective financial and human resource management through improved budgeting, accounting and reporting, and rooting out inefficiency particularly in public enterprises; Accountability in public services, including effective accounting, auditing and decentralization, and generally making public officials responsible for their actions and responsive to consumers; A predictable legal framework with rules known in advance; a reliable and independent judiciary and law enforcement mechanisms; and Availability of information and transparency in order to enhance policy analysis, promote public debate and reduce the risk of corruption. (ECA, 2003)

It is apparent from the above conception of "good governance" that there is some emphasis on improving public-sector management systems. Thus, in the good governance prescriptions, one finds public management reforms as a key component pointing towards market and private sector approaches to public sector management, under the guise of New

Public Management (NPM). (ECA, 2003). New Public Management (NPM) is a label used to describe a management culture that emphasizes the centrality of the citizen or customer, as well as accountability for results. It is a set of broadly similar administrative doctrines, which dominated the public administration reform agenda of most OECD countries from the late 1970s (Hood, 1991; Pollitt, 1993; Ridley, 1996). It captures most of the structural, organizational and managerial changes taking place in the public services of these countries, and a bundle of management approaches and techniques borrowed from the private-for-profit sector. (ECA, 2003)

Improved accountability in the conduct of public affairs is a reform objective. There is plenty of empirical evidence to show that even in consolidated democratic States in Africa, there are major deficits in accountability (Olowu, 1999; Therkilsden, 2001). Problems of accountability arise, for example, when: Governments ignore or transgress social ethics and constitutional and legal provisions in conducting public affairs; Tasks to be performed are so complex or unspecified that implementation is very difficult if not impossible; Activities are hidden; Corrupt practices are widespread; Political and personal loyalty are rewarded more than merit; and Public participation in running public affairs is low. (ECA, 2003)

Every audit committee must assume three fundamental responsibilities: Assessing the processes related to the company's risks and control environment, Overseeing financial reporting and evaluating the internal and independent audit processes.

The audit committee has proved to be an important organ in the prudent management and accountability for organizations around the world even to public corporations in various countries. (ECA, 2003) While experience of audit committees in the UK is shorter, it is encouraging, and around two-thirds of the top 250 UK listed companies now have them in place. Experience in the United States has shown that, even where audit committees might have been set up mainly to meet listing requirements, they have proved their worth and developed into essential committees of the board. Similarly, recently published research in the United Kingdom concludes that the majority of companies with audit committees are enthusiastic about their value to their businesses. They offer added assurance to the

shareholders that the auditors, who act on their behalf, are in a position to safeguard their interests. (ECA, 2003)

Audit committees should be formally constituted to ensure that they have a clear relationship with the boards to whom they are answerable and to whom they should report regularly. They should be given written terms of reference which deal adequately with their membership, authority and duties. Membership should be confined to the non-executive directors of the company and a majority of the nonexecutives serving on the committee should be independent. (GEE, 1992)

The audit committee should have explicit authority to investigate any matters within its terms of reference, the resources which it needs to do so, and full access to information. The committee should be able to obtain external professional advice and to invite outsiders with relevant experience to attend if necessary. The audit committee's duties should be determined in the light of the company's needs. (GEE, 1992) Membership of an audit committee is a demanding task requiring commitment, training and skill. The directors' concerned need to have sufficient understanding of the issues to be dealt with by the committee in order to take an active part in its proceedings. This is why committees should, if it is appropriate and within their authority, be able to invite outsiders with relevant experience to attend meetings. (GEE, 1992)

At a minimum, the audit committee as a whole should have recent and relevant experience and should possess a collective balance of skills and expert knowledge - commensurate with the complexity of the organisation and the duties to be performed - in financial reporting, accounting and auditing. (BCBS, 2010). All over the world stringent measures are being taken to ensure that there is proper accountability and expression of responsibilities from the board and the management of companies and organizations. (KPMG, 2000; BRC 1999). In America for instance, in the autumn of 1998, SEC Chairman Arthur Levitt announced the formation of a blue ribbon committee charged with developing a series of recommendations to enable audit committees to function as the "ultimate guardian of investor interests and corporate accountability." Officially called the "Blue Ribbon Committee on Improving the

Effectiveness of Corporate Audit Committees," the committee was sponsored jointly by the New York Stock Exchange (NYSE) and the National Association of Securities Dealers (NASD). (KPMG, 2000; BRC 1999)

Its eleven members contributed a diversity of experience associated with self regulatory organizations as well as the corporate community, investors, independent auditors, securities firms, and the legal community. The committee solicited public comments and held a public hearing in its quest to develop recommendations that would best help audit committees carry out their responsibilities. (KPMG, 2000; BRC 1999). The committee's recommendations, along with a number of guidelines for best practices for audit committees, were announced in February 1999. The recommendations are designed to improve financial reporting and focus on the oversight function where discretion and subjective judgments bear on the quality of financial reporting. There are ten recommendations in all. The first two are aimed at strengthening the audit committee's independence. (KPMG, 2000; BRC 1999)

### **2.7 Limits set by state corporations for action against reported cases of malpractices**

Scholars like Callaghy (1986), Nukunya (1992), Groenendijk (1997), Ruzindana (1998), Waliggo (1999), Osei (1999), and Rossouw (1999), traced the root causes of corruption in Africa to: prevalence of dictatorial rules, monetized or materialised economies, poor economic and educational empowerment of the citizenry, the "politics of the belly", making the public sector as the "prime mover" of economic development and the absence of national ethical and moral values and true patriotism. Appropriate measures, no matter how bitter, have to be adopted to root-out these causes of corruption, if Nigeria and indeed other African countries are really serious about the fight against corruption. There are many branches or dimensions of corruption in Nigeria, which need stringent measures in practice for effective prevention and control.

Auyo (1998), highlights some of them to include: abuse of power; ill - treatment of subordinates and indecent treatment of people's needs; self-award of contract; malicious withdrawal or 'carpeting' of personnel files; unnecessary delay of actions on certain demands; fraudulent distortion of facts and figures; nepotism; embezzlement and other

financial misappropriation; ghost worker systems; 10% syndrome; transfer of public funds to private accounts; over - invoicing; over - pricing of contracts; and arson, usually to cover -up corrupt practices. (Sowunmi, Raufu, Oketokun, Salako and Usifo, 2010)

Kalema, (2008), states that publicly owned development bodies that operate on sound corporate governance principles, are accountable and tasked with facilitating the development of private enterprises can make a positive contribution. They can assist in the financing of enterprise growth as well as providing managerial expertise to enterprises.

Prior to 2003, the government agencies known as parastatals were not known as centres of good service to the public. They were seen to serve at the whims and for the personal fulfillment of political leaders, and not the public. (Taboi, 2010). As a result, many were poorly run, known largely for corrupt procurement and other practices, and they accumulated deficits that the government was expected to fund to enable the parastatals to fund their operations, including salaries in some cases. This image largely changed with the new government. Ministers were given leeway in the appointment of directors at these companies and new metrics were introduced to the management of parastatals. (Taboi, 2010)

These included performance contracts for CEOs that cascaded down to line managers and staff, balanced scorecards, and push towards ISO certification - all of which promoted continuous improvement and better delivery of services to the public. Also, many of the new parastatals heads were picked from long, distinguished careers in the private sector, and the new management systems and guidance they brought translated to better and more competent management decision making. (Taboi, 2010).

Parastatals now competed and became celebrated for improved performance in several aspects - one of which was the practice of holding ceremonies annually to hand dividend cheques to the Finance Minister as well as being ranked as one category of KRA's top tax payers. The better management of parastatals also bore fruits in some cases by making them attractive for privatization. This allowed the government of Kenya to divest from parastatals e.g. the Kenya Electricity Generating Company (Kengen) and the Kenya Reinsurance Corporation (Kenya Re) - raising funds for other government programs, while allowing

members of the public to become shareholders through listing on the Nairobi Stock Exchange. (Taboi, 2010)

State ownership has had a number of negative impacts, for example, all SOEs are expected to achieve a number of noncommercial objectives that are defined by the state and must adhere to affirmative action norms for employment to ensure that the percentage of representation of certain groups (scheduled castes and tribes, the handicapped, former members of the military, and so on) is equal to that in central government ministries. (Goswami, 1996). In addition, because of pressure from the comptroller and accountant general's annual audit, they are inclined to accept the lowest bidder for procurement tenders, even when quality is poor, and they have little autonomy in making major decisions, including the appointment of senior management personnel or financial investments. (Goswami, 1996)

Two major corporate governance initiatives (after the security scams of 1992 - 94) have been launched in India since the mid-1990s; the first has been by the Confederation of Indian Industry, India's largest industry and business association, and the second by SEBI. More than a year before the onset of the 1997 Asian crisis the Confederation of Indian Industry set up a committee to examine corporate governance issues and recommend a voluntary code of best practices. The committee released "Desirable Corporate Governance: A Code" in April 1998. The code focuses on listed companies and provides detailed recommendations that address the items identified earlier in the scams. (Goswami, 1996)

Paine (1996) identified an organizational integrity-based stratagem that is more comprehensive and broader than the legal compliance strategy to encourage and support an ethical corporate culture. Four challenges which must be met before an organizational integrity approach can work: (1) developing an ethical framework, (2) aligning practice with principles, (3) overcoming cynicism, and (4) resolving ethical conflicts. In order to create an ethical compass or a framework for integrity, Paine (1994), also suggests a useful starting point is to begin by answering some questions to the four fundamental sources of responsibility: (1) What is the organization's fundamental reason for being - its ultimate aim

(purpose)? (2) Who are the constituencies to whom the company is accountable and on whom it depends for success? What are their legitimate claims and interests (people)? (3) What is the organization's authority and ability to act (power)? and (4) What are the organization's obligations or duties, as well as its guiding aspirations and ideals (principle)?

The situation in Kenya is hardly any different from the mentioned experiences and thus calls for measures to be taken by the government to catch corrupt and ill bent leaders in the state corporations, who are bent on making the corporations but their own individualized cash cows.

## **2.8. Conceptual Framework**

The conceptual framework is developed to examine the relationship between corporate governance practices and Audit committee functions. The link between governance practices and the audit committee activities are illustrated in Figure 1. In this conceptual framework, governance practices and audit committee activities are independent and dependent variables respectively. This study attempts to bridge the gap by providing a basis for a thorough and insightful discernment of the influence of corporate governance mechanisms on the audit committee activities. Although the causal relationships among the constructs, as shown in Figure 1, seem to be straightforward, in order to make practical statements about governance practice and its relation with audit committee activities, the conceptual framework requires further analysis

**Figure 1: The Conceptual Frame work**

**Independent Variables**

• The Audit Committee

Regularity of Meetings  
(at least 4 in a year)

Training of Audit  
Committee members

Composition of Audit  
Committee Members

**Dependent Variable**

Good Corporate Governance

Ranking of  
Organization  
j (Performance Contract)

3/

Unqualified Audit  
Report from KENAO

Employee Satisfaction  
Surveys

*r*

**Intervening Variables**

- o Remuneration
- o Government policy on Audit Committees
- o Reports by the Internal Auditor

**J**

## **2.9 Theoretical Framework of the Study**

A company's corporate governance function includes five main actors: management, the board of directors, the audit committee, the external auditors and the internal auditors (Cohen et al. 2004). One of the main objectives of corporate governance is to ensure a company's financial reporting quality. The interaction among corporate governance actors is crucial to achieve this objective (SOX 2002; Cohen et al. 2004). This study will focus on the audit committee function of corporate governance.

The aim of this section is to introduce the underlying theoretical foundations for this study. The agency theory will be introduced. Agency theory is a general theory of accounting which explains the demand for monitoring provided by audit committees and external auditors. The theoretical frameworks regarding corporate governance, audit committee effectiveness and audit quality are introduced.

These theories are:

Agency Theory (Fama and Jensen, 1976) and the Stakeholder Theory (Freeman, 1984)

### **Agency Theory**

The theory is rooted in the work of Berle and Means (1932) on the separation of firm ownership from management. It is also often credited to the landmark work of Jensen and Meckling (1976) and Fama and Jensen (1983). They suggested that Agency problems will arise in any circumstance where the Principal (owners, shareholders) employs the Agent (management) to undertake a number of duties on their behalf for a reward. Thus management acting as Agent to the Principals owe them a fiduciary duty of care to run the organisation in the best interests of the owners for a stipulated reward (Berle and Means, 1932; Jensen and Meckling, 1976; Pratt and Zeckhauser, 1985). However, Jensen and Meckling (1976) argue that conflicts of interest do inevitably exist between the management and owners of businesses in cases where owners are not managers. This is because the theory assumes a model of man (manager) that is self serving, individualistic and opportunistic in nature, who prefers to maximise his own utility functions at the expense of the owners. As a

result, the theory is built on the assumption that there is almost always a divergence of objectives between the goals of the management and those of the shareholders.

### **Stakeholder Theory**

One of the criticisms of Agency Theory is that it provides a short term perspective and explanation of the purpose of the firm (Freeman, 1984; Freeman, Wick and Parmar, 2004). Also, critics argue that its scope is narrow, since it projects the activities of the firm from the perspective of the shareholders only. An alternative proposition known as the Stakeholder Theory suggests that a firm's activities should be projected on longer and broader perspectives (Freeman, 1984). The theory posits that the essence of corporate activity is not only for the benefit of the shareholders, but also for the benefit of all relevant stakeholders (including the shareholders) and it is all these relevant stakeholders who should be the main remit of the modern firm (Freeman, 1984; Cadbury, 1992; Jensen, 2001). It argues that firms should be managed in such a way that they coordinate the diverging interests of their numerous stakeholders including employees, shareholders, customers, suppliers, the government and society in general. This consideration should thus impact upon the formulation of the corporate strategy of the organisation as a whole (Marcoux, 2003). The arguments for the stakeholder view of the corporation have often been premised on moral and business ethics (Phillips, 1997).

### **2.10 Summary**

This chapter covers literature review of the research questions to the study, reflecting on cases and studies undertaken by various persons over time on the training of status of state owned corporations and their management. It seeks out what has been done as well as the recommendations made for better management and accountability by the management of state owned corporations. This review of the literature brings us to the methodology of the study. The methodology chapter follows next and describes the method used in the research; the population, the research design and procedures and the data analysis.

## CHAPTER THREE

### METHODOLOGY

#### 3.1 Introduction

This chapter describes the research design employed in the study putting into perspective the characteristics of the population and the sampling design, the sampling technique and sample size, the data collection methods, the research procedures and the data analysis methods used.

#### 3.2 Research Design

Research design provides the glue that holds the research project together. Trochim, (2006) indicates that a design is used to structure the research, to show how all of the major parts of the research project - the samples or groups, measures, treatments or programs, and methods of assignment - work together to try to address the central research questions.

This research will employ the use of a case study. This type of research is used to obtain case study analysis in a descriptive study of the subject of research. A case study is typically a detailed analysis of a single or individual case (Lee, and Lings, 2008), where a case is defined as a single social setting. (Lee, and Lings, 2008). It supposes that one can properly acquire knowledge of the phenomenon from an extensive exploration. A descriptive study is one in which the problem is clearly defined and the variables known. Cooper and Schindler (2008), state that the problem is structured and well understood. The basic characteristics of a descriptive research is that it provides a descriptive analysis of a given population or sample in a qualitative, quantitative or a combination of both. In addition, both types of data can be presented and broad research questions used. This justifies the use of this design in that it enables the researcher to analytically explain the findings of the research based on the variables tested.

#### 3.3 Target Population

The population or target population is that entire group of items or cases from which you want to gather data. The study population will be obtained from KURA, however, the targeted sample population will be the management and the accounts department of the corporate organization.

### **3.3.1 Population**

The population of interest in this study will consist of the relevant staff of KURA in the finance departments and the audit committee in selected county headquarters across the country.

### **3.4 Sampling Procedure**

Sampling means deliberately limiting the number of cases in the study. It involves a risk of the study findings being not true for some of the left-out cases, but this risk can often be calculated and restricted on a tolerable level.

#### **3.4.1 Sampling Design and Sample Size**

##### **3.4.1.1 Sampling Frame**

The sampling frame will consist of a selected number of staff in the finance department and the audit committee in the county headquarters.

##### **3.4.1.2 Sampling Technique**

The sampling techniques that will be used will combine random sampling and stratified sampling in this study. To ensure a representative sample of staff we will make use of the stratified sampling technique. This will assure the researcher that he is accurately representing not only the overall population but each region as well. The strata's will then randomly be selected using a simple random sample to give each individual sample unit an equal opportunity to be included in the sample. If a random sample is properly made it contains no bias and it is therefore relatively representative of the population.

##### **3.4.1.3 Sample Size**

Evans *et al.*, (2000) says that a sample size is the number of observations in a sample. The actual sample size of the population will be drawn using simple random procedure. According to Welman and Kruger (2001), simple random sampling provides each member of the population with an equal chance of being included in the sample. The procedure involves an identification of all units of analysis in the sampling frame which are given consecutive numbers. A table of random numbers generated from a computer programme is then used to

ensure that each number has an equal chance of being selected. There is no human error or interference in the selection of the sample and the sample selected would be representative of the population. As in the EHS Manual (2011) suggests (as quoted by Tolonen, 2008) that sample size relates to the statistical precision of the survey results, whereas bias is the concern related to low response rate. The relative benefit from higher precision, and therefore higher number of participants, is better if the response rate is high. On the other hand, if the expected response rate is low, it will be better to spend resources on increasing the response rate than to increase the total sample size.

### **3.5 Methods of Data Collection**

Primary data will be collected using structured questionnaires. The questionnaires and research instruments will be developed from literature review and organized on the basis of background information of the respondents and the research questions to ensure relevance to the research problem. The questions will be tailored to establish the effect/impact of internal audit committees in KURA. Instruments description will be given and indicated whether researcher developed or were standardized instruments. A description of the nature of instruments or items used will be given and the validity, reliability and administration procedure provided.

According to Curmin and Slater (1996), the structure of the questionnaire should ensure that there is a flow from question to question and topic to topic, as would usually occur in a conversation. Special interest will be taken to ensure that there were no radical jumps between topics, which tend to disorient respondents and thus influence their answers. Closed ended items will be used to provide exact information needed by the researcher while open-ended questions will provide detailed information in the respondents own words. The use of structured questionnaires also requires minimal staff and enables the researcher to collect large amounts of data within the shortest time possible. It is fast and easy to administer and is perceived to be more anonymous which gives respondents courage to answer questions without fear of victimization. (Cooper and Schindler, 2003).

### **3.5.1 Research Procedure**

The research procedure will include a detailed description of the steps taken in the research. That is a complete account of the research process including the pilot testing, scheduling of subjects/participants, distribution and collection of instruments and running of experiments or testing of instruments. This procedures will include timing of interviews/questionnaires and instruments given to subjects. Questionnaires will be developed from specific research questions with respect to every stratified research sample unit. A pilot test will be conducted before the main research to test the efficacy of instruments. A draft questionnaire will be developed and a weeklong pilot testing carried out on pilot sample respondents randomly selected from the identified population. This will enable the researcher to redesign the questionnaire and make modifications where necessary before they are distributed to the respondents. The researcher and assistants will administer the questionnaires to respondents after training the assistants on what is to be done and ensure that they know their duties. At the end of administering the questionnaires, the researcher will collect the questionnaires and prepare them for analysis. The method of data analysis will incorporate a statistical analysis using computer-based tools that is Excel, SPSS. The analysis will look at quantitative approaches using descriptive and inferential statistics. Data will then be presented in tables, graphs and charts.

### **3.6 Validity and Reliability**

To ensure data validity, quality and reliability the same data will be collected each time over repeated tests/ observations during the pre-test of tools. Validation involves collecting and analyzing data to assess the accuracy of an instrument. The validity of quantitative instruments will be established using a panel of experts and a field pilot-testing conducted before the study. Establishing the eternal validity for the instrument will follow directly from sampling. Content validity for the appropriateness of the content of the instrument will involve taking representative questions from sampled population at the pilot testing and evaluating them against the desired outcomes. There will be randomization of the sample groups to ensure validity.

Reliability can be thought of as consistency. If the instrument consistently measures what it is intended to measure? In this study we will check reliability with the Inter-Rater/Observer Reliability check to determine that the degree to which different raters/observers give consistent answers or estimates, thus ensure reliability of our instruments. Reliability will be established using a pilot test by collecting data from 20-30 subjects not included in the sample. To assure reliability questions will be precisely worded without ambiguity and the qualitative coding will be consistent particularly with open-ended questions. There will be proper definition of key terms.

### **3.7 Operational Definition of Variables**

Actions against fraud - types of fraud and abuse; Policies, procedures and controls to mitigate any incidences of fraud or malpractices

Audit Committee - operating committee of a company's board of directors that is in charge of overseeing financial reporting and disclosure.

Board of directors - body of elected or appointed members who jointly oversee the activities of a company or organization

Monitoring - the monitoring of accounting policies, the oversight of any external auditors, regulatory compliance, and the discussion of risk management policies with management.

**Performance contract** - performance agreement between the Government, acting as the owner of a Government Agency, and the management of the Agency. It clearly specifies the intentions, obligations and responsibilities of the two contracting parties.

Quality of audit report - process of identifying and administering the activities needed to achieve the quality objectives of IAS (International Audit Standards)

**Table 3.7.1 Operational Definition of Variables**

<b>Variables</b>	<b>Indicator</b>	<b>Measurement</b>	<b>Scale/Ratio</b>
<b>Independent Variables</b>			
Training of Audit Committee Members	Certificates obtained	Trainings attended	<b>1-10</b>
Regular Meetings	Minutes of meetings	No. of meetings	<b>1:4</b>
Composition of Audit Committee Members	Field of Expertise of members	No of members coming from the same field of expertise	<b>1:4</b>
<b>Dependent Variables</b>			
Unqualified KENAO Audit Report	Letter from KENAO	KENAO Annual Audit Report	
Ranking of Organization performance	Rank in performance	Position in rankings	<b>1-10</b>
Employee Satisfaction Surveys	Attendance by member	No. of times present	<b>1-10</b>
<b>Interv ening Variables</b>			
Remuneration of Board Members	Sum given	Frequency period	
Timely and Well prepared audit reports	report	Number of reports	
Government policy on audit committee	Adherence to policy	Audited reports	

### **3.8 Methods of Data Analysis and Presentation**

Arsham, (2008), says that data analysis is the systematic application of statistical and/or logical techniques to turn raw data into information that can be used in making decisions. Whether it is being used to make decisions in business, science, policy-making or administration, the goal of data analysis is to turn good data into good decisions.

Descriptive statistics will be used to analyze data. According to Blade (1999), descriptive statistics particularly graphs and charts have the potential to enhance the understanding of outcomes of quantitative research. It also gives graphical presentations that are easy to understand. Quantitative data will be used to analyze data in terms of frequency distribution tables and percentages. To ensure easy data analysis, questionnaires will be coded numerically with a coding scheme for each variable of study. This means that each variable will be assigned an exclusive code. This eliminates errors and increases accuracy level of the results.

Data collected will be analyzed both qualitatively and quantitatively as appropriate. Data will be analyzed using the SPSS programme to group data because the programme has the capability to handle recurring needs of data analysis. This will enable the researcher to record variables and effect transformations. MS Excel will be used to produce graphs and summarized frequency table. Both qualitative and quantitative techniques will be employed in the study.

### **3.9 Summary**

This chapter covers the population and the sampling design, the sampling technique and sample size, the data collection methods, the research procedures and the data analysis methods to be used. This are expressed to help the researcher obtain objective information for analysis. The data information analyzed herein leads us to the discussions and conclusions of the findings in the following chapter 4.

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APPENDICES

**APPENDIX Is RESEARCH INTRODUCTORY LETTER**

RAPHAEL MURIMI GITHINJI

UNIVERSITY OF NAIROBI

P.O. BOX 30197 - 00100 GPO, NAIROBI

NAIROBI.

RE: THE ROLE OF THE AUDIT COMMITTEE IN THE CORPORATE GOVERNANCE  
OF STATE CORPORATIONS: A CASE OF THE KENYA URBAN ROADS  
AUTHORITY (KURA)

Dear Respondent,

I am carrying out research on The Role of the Audit Committee in the Corporate Governance of State Corporations: A case of the Kenya Urban Roads Authority (KURA). This is a study in partial fulfillment of the requirement for the Master of Arts Degree in Project Planning and Management at the University of Nairobi

This research uses KURA as the case study from which you have been selected as one of the respondents. The result of this study will provide the analysis of the role played by the audit committee in parastatals to ensure good corporate governance practices.

This is an academic research and confidentiality is strictly emphasized, your name will not appear anywhere in the report. Kindly spare some time to complete the questionnaire attached.

Thank you in advance,

Yours Faithfully,

RAPHAEL MURIMI GITHINJI

## APPENDIX II: RESEARCH QUESTIONNAIRE

### Kt "RA ANALYSIS QUESTIONNAIRE

#### PART A

**Please tick in the box or write in the space for each question as applicable**

This questionnaire is designed to help the researcher learn from the staff their experiences with the internal audit committee. The findings from this study will be used to improve the effectiveness of the internal audit committee in parastatals

#### Demographics and General Information

##### General

Gender: Male      Female

Age: 13-20      21 - 30      31 - 40      41 - 50 I      over 50

**Highest Level of Education:** Primary      Secondary      College      University

Religion: Christian <sup>r—</sup>      Muslim <sup>\*—</sup>      other (please specify)

##### Work Related

**Name of Parastatal:**

Department:

Rank/Position:      Casual      Supervisor      Manager      Director •

Other

**Number of Years worked:**

Income Range: 1000- 10,000      10,000-50,000      50,000- 100,000  
Over 1000,000

PARTB

**1. The effect of training of the Audit Committee members in improving good**

**corporate governance**

Please rank the following statement by marking them with an X depending on your agreement with them

The effect of training of the Audit Committee members	Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree
very important for making members know which accounting standards apply					
Enables members to recognize the relationships between incentives and the likelihood of management deception in order to improve audit committee judgment.					
Makes them understanding the expectations of being an audit committee member					
Makes them have an in-depth understanding of the organization's business, background, etc					
Enables them understand the dynamics of audit committee meetings, including, frequency of meetings, preparation for the meetings, etc.					
To understand the audit committee's role in the investor relations process and how it can manage its relationship with directors, management, internal and external auditors					
To have a high level overview of the internal control framework and enterprise risk management and the role of internal audit					
Ensures that members have an understanding for controls over management reporting					
ensures integrity of members in accounting and financial reporting systems that include independent audit that have appropriate financial controls, risk monitoring, and compliance with laws and regulations					
Ensures members understand benchmarks of an effective and efficient audit committee					
That members are current on developments in corporate governance procedures and practices					
Ensures that members understand the various types of frauds with a focus on industry specific issues, for example training for fraud prevention					
That members have an understanding of the guidelines have a whistle blowing network for the detection of fraud					

**2. The composition of the Audit Committee members in improving good corporate governance**

<b>The composition of the Audit Committee members</b>	<b>Strongly Agree</b>	<b>Agree</b>	<b>Neutral</b>	<b>Disagree</b>	<b>Strongly Disagree</b>
Comprises at least one member with financial or accountancy competences.					
It is composed of independent members					
Should consider rotating audit committee members periodically.					
Should engage independent advisers to help evaluate the audit committee's performance when necessary.					
Independent member should be independent in relation to the company, its directors and controlling shareholders.					
Members should have the requisite skills, knowledge, and degree of independence.					
The expertise and competence requirements of the committee members, as well as a succession plan, should be evaluated in the context of the company's current strategy and expected risk profile					
The members' level of commitment and availability should also be considered					
Committee members should maintain and update the knowledge and skills required by their duties.					
The committee members should have a good understanding of the company's operations and its significant risks					
Should be composed solely of outside directors which oversees audit functions and the system of internal control.					
audit committees consist of at least four members					

### 3. The effect of regular meetings of the Audit Committee on good corporate governance

~~pleast rank the following statement by marking them with an X depending on your agreement with them~~

The effect of regular meetings of the Audit Committee	Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree
Committee members must personally attend the meetings and cannot be represented by another member					
Meet with external and internal auditors on a regular basis to stay informed about the planning, direction and scope of the audit,					
1 Conduct an annual evaluation of the external auditors' work.					
The Audit Committee meets as often as it deems • necessary and at least twice a year prior to the Board meetings called to review the yearly and half-yearly accounts.					
Meetings should start and end with summaries so that all members have a common understanding of what has transpired and what the priorities are.					
Reserve the right to invite any group or individual to an audit committee meeting					
Ensure all members actively participate in setting the committee agenda, and whenever possible avoid conducting committee business between meetings					
At the beginning of each meeting, review the previous meeting's highlights					
At the end of each meeting, summarize the meetings discussion					
Have Audit Committee Timetable and schedule of activities					

### APPENDIX III: RESEARCH PROPOSAL BUDGET ESTIMATES

BUDGET ITEM	COST (KSHS.)
PROPOSAL DEVELOPMENT Writing materials 3 Reams @ 400 = 1,200 Typing and printing = 6,000 Photocopying =2,500	9,700
DATA COLLECTION Research Assistant Fees = 1,000 per day = 14,000 Printing & Photocopying of Questionnaires = 4,000 Travels and meals, per diem - Research Assistant @ 2,500 per day x 2 weeks =35,000	53,000
DATA ANALYSIS AND REPORTING Stationery and Printing and binding of report	5000
CONTINGENCIES (10%)	6,750
<b>TOTAL</b>	<b>74,250</b>

**APPENDIX IV: RESEARCH IMPLEMENTATION SCHEDULE 2012**

Activity	June	June	June	July	July	August	August	August	Aug <sub>UK</sub>	Sep	Oct
Proposal Design	X										
Proposal Presentation		X									
Receipt of marked proposal		X									
Correction of Proposal		X									
Resubmit corrected proposal			X								
Permission for data collection			X								
Data collection				X	X						
Data Analysis and Reporting						X	X				
Project compilation								X	X	X	
Report Review and Approval										X	
Submission of Approved Report											X