

**EFFECT OF CORPORATE GOVERNANCE ON AUDIT QUALITY OF
COMMERCIAL BANKS LISTED AT NAIROBI SECURITIES EXCHANGE**

BY

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**A DISSERTATION SUBMITTED IN PARTIAL FULFILLMENT OF THE
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DECLARATION

I declare that this dissertation is my original work and has not been previously published or submitted elsewhere for award of a degree. I also declare that this contains no material written or published by other people except where due reference is made and others dully acknowledged.

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have been adequately addressed.

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ABSTRACT

This study aimed to explore the effect of corporate governance on audit quality within the context of commercial banks listed at the Nairobi Securities Exchange. More specifically, the study sought to determine the effect of board independence on audit quality of commercial banks listed at NSE; ascertain the effect of board diversity on audit quality of commercial banks listed at NSE; and establish the effect of board compensation reviews on audit quality of commercial banks listed at NSE. Grounded on the Stewardship, Agency and Stakeholder theories, the study adopted quantitative approaches. The target population for this study was the 12 commercial banks firms listed at the NSE, on which a census was conducted. The data collection approach for this study was the use of systematic review of reports and company documents from the sample of commercial banks listed in the NSE between the tracking period 2018 to 2022 was done. Both descriptive and logistic regression analyses were conducted. Results indicate that board independence ($B = 3.214$, $df = 1$, $p < .001$); board diversity ($B = -2.347$, $df = 1$, $p < .001$); and board compensation reviews ($B = 1.892$, $df = 1$, $p < .001$) have a significant effect on audit quality. This finding suggests that, within the context of NSE-listed commercial banks, board independence, board diversity and board compensation directly influence audit quality outcomes. It is recommended that policymakers and regulators should focus on enhancing regulatory oversight mechanisms to ensure robust governance practices within commercial banks. This includes developing clear guidelines and standards for Board Compensation, independence, diversity, and compensation practices. Regular assessments and audits should be conducted to ensure compliance with these standards and to identify areas for improvement.

Key Words: Board Independence, Board Diversity, Board Compensation Reviews, Audit Quality

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DEDICATION

This dissertation is dedicated to my Family and colleagues for their generous support, encouragement, and mentorship during my period of study for the Master of Science in Commerce, Finance, and Investments degree.

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ACRONYMS AND ABBREVIATIONS

AQ:	Audit Quality
CEO:	Chief Executive Officer
CG:	Corporate Governance
CMA:	Capital Market Authority
CMC:	CMC Motors Group Limited
IAASB:	International Auditing and Assurance Standards Board
ICGN:	International Corporate Governance Network
KPI:	Key Performance Indicators
NSE:	Nairobi Securities Exchange

OPERATIONAL DEFINITION OF TERMS

Corporate Governance – is defined as a set of rules, practices, and processes by which an organization is controlled and managed (Kyere & Ausloos, 2021). In this study, corporate governance is evaluated through three key aspects, that is board independence, measured by the ratio of independent directors to total directors on the board; board diversity measured by the percentage of female directors relative to male directors on the board; and board compensation reviews measured by the yearly percentage change in the total compensation (salaries and rewards) for board members.

Audit Quality – refers to the level at which matters contributing to the probability that an auditor will obtain credible financial reports that are free of material misstatements and errors detected are communicated (Xiao, Geng, & Yuan, 2020). In this study, audit quality is measured as a binary variable based on specific criteria: 1 indicates the use of the big four auditors, that is Deloitte, Ernst & Young (EY), PricewaterhouseCoopers (PwC), and Klynveld Peat Marwick Goerdeler (KPMG), and 0 indicates use of other audit firms outside the big four.

Board Independence - describes the ability of a board to be self-reliant and free of any influence from owners and stakeholders of an organization in decision-making (Ningrum,2021). This is measured by the ratio of independent directors to the total number of directors on the board. A higher ratio indicates greater board independence.

Board Diversity- refers to the composition of members of a board in regard to background, gender, demographics, skills, competencies, and experiences (Goyal, Kakabadse, & Kakabadse, 2019). In this study, board diversity is specifically measured by the percentage of female directors to male directors on the board. A higher percentage indicates greater gender diversity

Board Compensation Reviews – refers to motivation accorded to executives in the form of cash incentives, retainers, grants, and other financial benefits (Kolev et al., 2019). This is measured by the yearly percentage change in the total compensation (salaries and rewards) for board members. A positive percentage indicates an increase in compensation, while a negative percentage indicates a decrease

Listed Commercial Banks at NSE: Listed commercial banks refer to the banks that are publicly traded on the Nairobi Securities Exchange (NSE). The study focuses on all commercial banks listed at the NSE as of the most recent fiscal year, encompassing various financial and governance metrics as reported in their annual financial statements and reports.

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Audit quality is a cornerstone of corporate transparency and accountability globally. High-quality audits guarantee the dependability and correctness of the accounting records, which are crucial for stakeholders, including investors, regulators, and the public. The International Auditing and Assurance Standards Board (IAASB) defines audit quality as the provide reassurance that there are no substantial misstatements in financial accounts and comply with applicable accounting standards (IAASB, 2020). This assurance is fundamental in maintaining investor confidence and ensuring the smooth functioning of capital markets. Notable global financial scandals, such as the collapse of Enron in the early 2000s, have exposed significant deficiencies in audit practices, leading to increased scrutiny and the development of more stringent international auditing standards (Velte, 2023). Similarly, the downfall of Wirecard in Germany in 2020 highlighted failures in audit oversight and regulatory gaps, prompting calls for stronger enforcement of audit standards and auditor independence (Reuters, 2020).

Regionally, the importance of audit quality is also emphasized by financial authorities and exchanges. The African Securities Exchanges Association (ASEA), for instance, underscores the need for high audit standards to bolster the credibility and integrity of African financial markets. The Johannesburg Stock Exchange (JSE), one of the leading exchanges on the continent, has adopted rigorous audit regulations to ensure transparency and attract both local and international investors (ASEA, 2022). These measures include mandatory independent audit committees and enhanced disclosures in financial reporting, which help to mitigate the risks of financial misstatements and fraud. Another regional case is the collapse of Steinhoff International in South Africa, which was one of the largest corporate

frauds in the country's history. The scandal revealed significant lapses in both corporate governance and audit processes, underscoring the need for stricter audit oversight (Business Insider South Africa, 2017).

In East Africa, the Nairobi Securities Exchange (NSE) plays a pivotal role in the regional financial ecosystem. The NSE has made significant strides in promoting audit quality among its listed firms to enhance market integrity and investor confidence. However, despite these efforts, challenges persist. The Capital Markets Authority (CMA) of Kenya reported in 2019 that nearly half of the NSE-listed companies, including commercial banks, were in breach of corporate governance standards, particularly in the areas of financial reporting and audit processes (CMA, 2019). This highlights a critical issue within the banking sector, as robust corporate governance is essential for maintaining trust and transparency in financial institutions. In commercial banks, the quality of audits directly impacts the reliability of financial statements, which are crucial for investors, regulators, and other stakeholders. Failure to uphold these standards not only undermines public confidence but also threatens the stability of Kenya's financial market. The persistent governance challenges and weak audit processes in commercial banks suggest that current regulatory frameworks are insufficient in ensuring compliance, pointing to the need for stronger enforcement and oversight (Kimani et al., 2021).

Within Kenya's banking sector, financial malpractices have emerged as a serious concern, with audit failures playing a key role in several high-profile collapses. Cases like Chase Bank and Imperial Bank, both of which experienced significant financial irregularities leading to their eventual closure, underscore the impact of poor governance and weak audit frameworks (Jamhuri et al., 2022). These banks faced allegations of fraudulent accounting practices, including concealing bad loans and misstating financial positions, which auditors failed to detect or adequately address. The collapse of these institutions not only resulted in

massive financial losses for depositors and investors but also raised questions about the role of auditors in safeguarding the interests of stakeholders. Such instances demonstrate that poor audit quality in commercial banks is a systemic issue that requires immediate attention.

Efforts to improve audit quality in Kenya's financial sector have been driven by both regulatory reforms and professional initiatives. The Institute of Certified Public Accountants of Kenya (ICPAK) and the CMA have introduced measures to strengthen the audit profession, focusing on adherence to international auditing standards and promoting best practices within commercial banks (Kimani et al., 2021). These organizations emphasize the importance of auditor independence, ethical conduct, and continuous professional development to ensure that auditors can effectively perform their duties. Furthermore, commercial banks are being encouraged to adopt more transparent and accountable governance structures, including diverse and independent boards, which can provide stronger oversight of audit processes. In fostering a culture of integrity within the audit profession, these initiatives aim to improve the overall audit quality in Kenya's banking sector Jamhuri et al., 2022.

Despite these efforts, significant gaps remain in achieving high audit quality across all listed commercial banks in Kenya. While regulatory bodies have introduced reforms, there is still a pressing need for more stringent enforcement of corporate governance standards. Many commercial banks continue to face challenges in maintaining adequate internal controls and ensuring the independence of auditors, which undermines the effectiveness of their audits. Enhancing audit quality will require more than just regulatory compliance; it will also demand a shift in corporate culture towards greater transparency and accountability. A strong linkage between good corporate governance practices and high audit quality is essential, as effective governance provides the oversight necessary to ensure accurate financial reporting

(Kimani et al., 2021). As such, strengthening both governance and audit frameworks is critical for improving investor confidence and ensuring the long-term stability of

1.1.1 Corporate Governance

Corporate governance refers to the frameworks, principles, and processes by which corporations are directed, managed, and held accountable to their stakeholders, including shareholders, management, and the board of directors (Sajid Gul et al., 2013). This governance encompasses a wide range of practices aimed at ensuring the firm's objectives are achieved efficiently and ethically. Fundamental principles such as accountability, transparency, independence, social responsibility, and fairness are essential components of robust corporate governance (Cooper, 2014). These principles not only support the sustainability and ethical operation of firms but also play a crucial role in enhancing audit quality and overall financial performance (Harjoto & Jo, 2021). Within this context, three critical elements of corporate governance stand out: board independence, board diversity, and board compensation reviews.

An independent board, free from conflicts of interest and composed of members who are not part of the company's management, is better positioned to provide unbiased oversight and critical evaluation of the company's financial practices and internal controls (Rahman et al., 2023). Independent directors can challenge management decisions and ensure that financial reporting and disclosure practices meet the highest standards of accuracy and integrity. Research has shown that firms with a higher proportion of independent directors tend to exhibit higher audit quality, as these directors are more likely to demand thorough and objective audits (Soliman, 2020).

Board diversity is another crucial factor in promoting effective corporate governance and audit quality. A diverse board brings together a wide range of experiences, skills, and perspectives, which enhances decision-making processes and promotes more comprehensive

oversight (Harjoto & Jo, 2021). Diversity with regard to ethnicity, gender, expertise and professional background can help boards to better understand and address complex business challenges, mitigate risks, and ensure that A realistic and accurate picture of the business's financial state is given by its accounting records (Bear et al., 2020). Studies indicate that diverse boards are more likely to foster a culture of openness and diligence, which positively influences audit quality (Kang et al., 2022).

Board compensation reviews involve the systematic evaluation and adjustment of the remuneration and incentives given to board members to ensure they align with the company's long-term goals and shareholder interests (Hermalin & Weisbach, 2023). In establishing fair and performance-based compensation structures, firms can motivate board members to prioritize the company's financial health and ethical practices. Effective compensation reviews help mitigate risks associated with overpayment or underpayment, which can lead to conflicts of interest and reduced board effectiveness (Bebchuk & Fried, 2024). Importantly, well-structured compensation reviews are crucial for enhancing audit quality, as they ensure that board members remain committed to transparency and accountability, thereby supporting rigorous and unbiased audit processes (Xie et al., 2023).

The choice of board independence, board diversity, and board compensation reviews as elements of corporate governance in this study is grounded in their critical roles in enhancing corporate accountability, performance, and transparency. Board independence is vital as independent directors are more likely to provide unbiased oversight, reducing potential conflicts of interest and enhancing the integrity of financial reporting (Fama & Jensen, 2019). Board diversity, particularly gender diversity, brings a range of perspectives and experiences, which has been shown to improve decision-making and corporate performance (Carter et al., 2022). Furthermore, board compensation reviews are essential in aligning the interests of board members with those of shareholders, ensuring that

compensation is linked to performance and encouraging long-term value creation (Core et al., 2023). Together, these elements are fundamental to fostering a robust governance framework that can positively influence audit quality by promoting greater scrutiny, inclusivity, and alignment of incentives within the boardroom.

1.1.2 Audit Quality

Audit quality is a multifaceted concept that fundamentally rests on two major aspects: technical capability and auditor independence (Boland et al., 2020). Technical capability refers to the proficiency and competence of auditors in identifying material breaches and errors in financial statements. This encompasses a broad range of skills and knowledge in accounting and financial reporting standards, including a deep understanding of the applicable regulatory frameworks, the ability to apply complex accounting principles correctly, and the expertise to use advanced auditing techniques effectively (Knechel et al., 2023). Ensuring that auditors are technically competent is crucial, as it directly impacts their ability to detect inaccuracies and prevent financial misstatements (DeFond & Zhang, 2023).

Auditor independence is the second critical pillar of audit quality. It involves the auditor's ability to report material breaches objectively and without any undue influence from stakeholders (Francis, 2021). Independence in auditing implies that in order to maintain their objectivity, auditors need to be void of issues of influence (Geiger & Raghunandan, 2022). Because stakeholders rely upon accountants to offer an objective evaluation of the financial condition of an organization, this independence is crucial to preserving the trustworthiness and dependability of the procedure for auditing. Regulatory frameworks often emphasize the importance of auditor independence by imposing strict guidelines on auditor relationships and activities to avoid potential conflicts of interest (Svanström, 2023).

High audit quality ensures that financial statements are accurate, complete, and free from material misstatements, which is crucial for stakeholder decision-making (Rahim,

2020). Accurate financial reporting is vital for investors, creditors, and other stakeholders who depend on reliable information to make informed decisions (Gaynor et al., 2019). High-quality audits enhance the trust and confidence of these stakeholders in the financial information presented by companies, thereby facilitating better investment decisions and contributing to the overall stability and efficiency of financial markets. Furthermore, high audit quality can mitigate the risks associated with financial fraud and corporate misconduct, which can have severe repercussions for companies and economies at large (Johl et al., 2022).

The effectiveness of internal controls, a critical component of corporate governance, also plays a significant role in determining audit quality. Strong internal controls provide assurance on the accuracy and completeness of financial information by ensuring that adequate checks and balances are in place within the organization (Ndungu, 2014). Effective internal controls help prevent errors and fraud, support compliance with laws and regulations, and promote operational efficiency (COSO, 2023). Auditors assess the design and operational effectiveness of these controls as part of their audit process, and robust internal controls can significantly enhance the quality of the audit by cut down on the possibility of major inaccuracies (Cohen et al., 2024).

In addition to internal controls, outside elements like regulatory supervision and professional standards also influence audit quality. Regulatory bodies and professional organizations establish standards and guidelines that auditors must follow to ensure the quality and integrity of their work (PCAOB, 2015). For instance, IAASB issues international standards on auditing (ISAs), which provide a comprehensive framework for conducting high-quality audits (IAASB, 2020). Compliance with these standards helps ensure that audits are performed consistently and in accordance with best practices, thereby enhancing the overall quality of audits globally (ICAEW, 2016).

Finally, continuous education and training are essential to maintaining and improving audit quality. The dynamic nature of business environments, advancements in technology, and changes in regulatory frameworks necessitate that auditors continually update their knowledge and skills (Arel et al., 2022). Ongoing professional development programs help auditors stay abreast of the latest developments in accounting and auditing standards, emerging risks, and innovative auditing techniques (Christensen et al., 2022). By investing in continuous education and training, audit firms can enhance the technical capability of their auditors, ensuring they are well-equipped to deliver high-quality audits that meet the evolving needs of stakeholders (Lennox et al., 2023).

1.1.3 Listed Commercial Banks In Kenya

The Nairobi Securities Exchange (NSE) issues Corporate Governance guidelines that underscore the significant contribution of Internal Audit to best practices adopted by companies. Firms listed on the NSE are mandated to have an Internal Audit department where the Audit function established by the board of directors is independent of the activities they audit (Capital Market Authority Act Cap 485 A). As of recent data, the Nairobi Securities Exchange (NSE) has 11 commercial banks listed under its financial services segment. These banks represent a significant portion of the country's banking industry in terms of assets, customer base, and market capitalization. They play a critical role in providing financial services, driving economic growth, and contributing to the stability of Kenya's financial system. Due to their public listing, these institutions are subject to stringent regulatory and corporate governance requirements under the Capital Markets Authority (CMA) and the Central Bank of Kenya (CBK) (Aluoch, 2023).

Corporate governance is an essential aspect of listed commercial banks, particularly because of their impact on financial stability and investor confidence. In the context of these banks, corporate governance refers to the system by which they are directed and controlled. This includes the structures and processes for decision-making, accountability, and control, as

well as the relationships among a bank's management, its board, shareholders, and other stakeholders (Mwaniki, 2023). The corporate governance structures of listed commercial banks in Kenya are shaped by both local regulations and international best practices, such as the Basel Committee on Banking Supervision guidelines and the Capital Markets (Corporate Governance) (Market Intermediaries) Regulations, 2011. The board of directors plays a pivotal role in overseeing management, ensuring transparency, and protecting the interests of shareholders and stakeholders (Kimani et al., 2021).

For listed commercial banks, the robustness of corporate governance directly impacts the quality of both internal and external audits. Corporate governance practices typically entail board independence, diversity and compensation reviews. Independent boards, with diverse skills and experience, strengthen the audit process by providing oversight free from management influence (Lyons, 2022). The CMA in Kenya mandates that a portion of a bank's board be composed of independent non-executive directors. A more independent board has been linked to enhanced audit quality due to its ability to effectively challenge management's decisions and ensure that external auditors remain unbiased (Kinyua, 2022). Corporate governance frameworks often impose rules on auditor independence, a crucial factor in audit quality. The Central Bank of Kenya (CBK) has guidelines that prevent the same audit firm from auditing a bank for an extended period to ensure that audit relationships remain objective. Research has shown that auditor rotation can improve audit quality by reducing the risk of familiarity threats that compromise audit rigor (Ngugi et al., 2021).

In the context of Kenyan listed commercial banks, board diversity plays a critical role in enhancing corporate governance and audit quality (Mutua, 2022). Diversity in gender, age, educational background, and nationality on bank boards introduces varied perspectives that improve decision-making, risk oversight, and corporate transparency. Gender diversity, in particular, has gained prominence, with women in leadership contributing to stronger

financial scrutiny and more effective governance (Waweru & Kisaka, 2020). Similarly, a mix of younger and older board members ensures innovation while maintaining seasoned oversight. Banks such as KCB Group and Equity Group Holdings have embraced diversity, resulting in improved governance structures that support higher audit quality (Aduda & Musyoka, 2021).

Board compensation also significantly influences governance and audit integrity. Performance-based compensation structures that align with long-term strategic goals encourage directors to prioritize sound financial oversight and effective risk management (Kinyua, 2022). Transparent compensation policies ensure that board members maintain independence from management, thereby enhancing their ability to oversee audits objectively. Conversely, excessive compensation can lead to governance failures by compromising board independence. Overall, well-balanced compensation, as seen in banks like Absa Bank and Stanbic Holdings, strengthens board accountability and promotes a governance environment conducive to high audit quality (Ngugi et al., 2021).

1.2 Research Problem

In the dynamic and rapidly evolving financial landscape, audit quality plays a critical role in ensuring the transparency, reliability, and integrity of financial reporting (Soliman, 2020). High audit quality is essential for maintaining investor confidence, supporting market efficiency, and safeguarding the interests of various stakeholders, including shareholders, regulators, and the public (Boland et al., 2020; Rahim, 2020). Robust and independent audit processes should ensure that financial statements are accurate and free from material misstatements, leading to enhanced stakeholder trust, increased foreign investment, and a more resilient financial market (Rahim, 2020; Ndungu, 2014). Ideally, companies would adhere to the highest standards of corporate governance, facilitated by effective internal audit

functions that provide unbiased oversight and ensure compliance with regulatory requirements (Sajid Gul et al., 2013).

Despite the establishment of rigorous audit standards and regulatory frameworks, audit quality issues persist among companies listed on the Nairobi Securities Exchange (NSE), including commercial banks. The Kenyan banking sector has been marred by financial scandals and corporate governance failures that raise significant concerns about audit quality. For instance, National Bank of Kenya and Chase Bank faced regulatory scrutiny due to inadequate internal controls and poor governance practices, leading to misstatements and financial irregularities (Capital Markets Authority, 2019). Such lapses erode investor confidence, lead to significant financial losses, and jeopardize the stability of the Kenyan financial system (Kimani et al., 2021; Mwaniki, 2023). Furthermore, board independence, board diversity, and board compensation reviews are crucial corporate governance elements that have been under-examined in relation to audit quality in this sector, despite their critical role in ensuring financial transparency and accountability.

The scant exploration of corporate governance's impact on audit quality, specifically in the context of commercial banks listed on the NSE, leaves a gap in the Kenyan body of knowledge. While studies such as Ibrahim et al. (2019) have explored the relationship between board independence and audit quality in other sectors, few have focused on the unique characteristics and challenges of the banking industry, which is a cornerstone of Kenya's economy. Given the sector's pivotal role in financial intermediation, understanding how corporate governance practices such as board diversity and compensation affect audit quality in these institutions is vital. This study seeks to address these gaps by investigating the effect of corporate governance on the audit quality of commercial banks listed on the NSE, contributing to a more resilient and transparent financial system. Without addressing these issues, Kenyan commercial banks may continue to experience financial misstatements

and governance failures, undermining both investor confidence and the broader market's stability (ASEA, 2022; The East African, 2024).

1.3 Research Objectives

1.3.1 General Objective

The general objective of the study is to determine the effect of corporate governance on the audit quality of commercial banks listed at NSE.

1.3.2 Specific Objectives

The following are the specific objectives of the study;

- i. To determine the effect of board independence on audit quality of commercial banks listed at NSE
- ii. To ascertain the effect of board diversity on audit quality of commercial banks listed at NSE
- iii. To establish the effect of board compensation reviews on audit quality of commercial banks listed at NSE.

1.4 Research Questions

The research seeks to answer the following questions:

- i. To what extent does board independence have an effect on audit quality of commercial banks listed at NSE?
- ii. How does board diversity have an effect on audit quality of commercial banks listed at NSE?
- iii. Do board compensation reviews have an effect on audit quality of commercial banks listed at NSE?

1.5 Significance of the Study

This research has significant implications to both the academic and business domains of the sphere of business banking. Within the broader context of all commercial banks, this study homes in on a particular subset to draw empirical insights that contribute substantively to a growing body of literature regarding corporate governance and audit quality. The study focuses on the nitty-gritty of board diversity, board independence and board compensation reviews to shed light on these critical governance issues that may significantly impact the audit quality demonstrated by such financial organizations. This makes this study relevant not only into the realm of theoretical discourse but has practical applications to commercial banks as well as the policymakers and industry practitioners.

A more in-depth examination of such governance factors mentioned above aims at unravelling insights which actually have direct potential implications on the audit quality trajectory of commercial banks. As this research is highly evidential based, it tends to facilitate us to empower our knowledge pertaining to the complex linkage prevailing between the governance structures and the audit procedures in the commercial banks. Apart from its academic implications, this research possesses prospective implications regarding the business strategies as well as decision-making in the context of commercial banks. The same results may prove useful in other strategic initiatives tailored towards maximizing the strength of governance frameworks to enhance audit quality and overall financial performance.

The practical ramification of the study is relevant in that it deals with board diversity, independence as well as compensation reviews which may be used as a mechanism through which effective corporate governance is advocated in commercial banking institutions. As the study unfolds, it is expected that these implications will reverberate not only within the corridors of academics but also within the corridors of commercial banks to lend them useful insight into governance practices which can produce beneficial effects on audit quality. Such

an approach to the research therefore seeks to contribute not only to the understanding of corporate governance and audit quality in the commercial banks per se but to the general understanding of efficient corporate governance practices within the financial sector.

1.5.1 Researchers

The results of this study will be extremely significant to parties academically and other researchers as it will deepen knowledge of the complex interaction between corporate governance practices and audit quality in a developing and dynamic market like Kenya. It will offer a practical case study for upcoming corporate governance research and ideas that can be used in a wider context.

1.5.2 Commercial Banks

The results of the study will be useful for players within banking industry in Kenya. It will provide practical advice on how to improve the make-up and operation of their boards to raise audit quality. Additionally, regulators and policymakers can use these insights to improve corporate governance principles, modifying them to meet the unique requirements and difficulties of the Kenyan banking industry.

1.5.3 Higher Education Institutions

This research is significant to higher educational institutions as it contributes towards academic knowledge and even improves the said educational programs in the areas of business, finance, and corporate governance. This is a contribution to the theoretical discourse around corporate governance and audit quality in the banking sector that higher learning institutions are pulling their socks to provide learners with real and up-to-date insights. The focus on board independence, diversity, and compensation reviews presents nuanced insights to the intricate relationships that shape governance structures and audit procedures in commercial banks. Inclusion of the findings in these pieces of academic curriculum allows students build on various skills and hands-on experience with regards to

the real-world challenges and practice of financial sector (Ary, 2018). Additionally, the research is founded on empirical research that provides it with a practical angle linking theoretical concepts to how they are applied in real banking practice.

Results from the research can also be utilized within institutions of higher learning to advance teaching techniques based on research and to encourage an attitude of being analytical and critical in their students. Relevance of the study for educationalists lies in the fact that by revealing the governance factors affecting the quality of an audit, this research can be implemented to apply in case studies, discussions, or projects on this subject in order to convey studied concepts in a more meaningful and dynamic way.

1.5.4 Regulators

This research is, therefore, relevant to the regulators of the banking industry as it provides empirical evidence on the indispensable elements of corporate governance and audit quality. The findings can help the regulators in giving policy advice, a regulatory framework, and guidelines that uphold good governance practices within commercial banks (Anginer et al.,2018). Knowledge on how audit quality board independence, diversity and compensation affect reviews means that the regulators are armed with evidence-based knowledge from which they can develop much more effective and particularly geared regulations. The regulators, therefore, present regulatory measures corresponding to the stability, transparency, and integrity that the study finds in the industry. This makes the research an invaluable tool for regulators as it offers insights into the various governance mechanisms that affect financial institutions since a strong corporate governance is a key prerequisite that banks need to sustain their integrity.

1.5.5 Industry Players

Most significantly, in this regard, the study is relevant for the industrial players in the banking industry in that it provides concrete recommendations with regards to governance

elements influencing the audit quality. Taking into consideration the influence of board independence, diversity and compensation reviews, financial firms would improve their corporate governance systems. The results of the study thus offer critical benchmarks and thus enable banks to enhance development of their governance practices hence resulting in better quality audit and thus financial performance (Bhagat and Bolton,2019). Thus, this research uses this to allow informed strategic judgment on the part of industrial players in reorganizing board structures such as efficient compensation policies that help the institution in its long-term sustainability for competitive success. Besides, the influence of research on business strategies goes in line with increasing focus to governance excellence by companies within the industry which offers the financial institutions a guide in managing daunting governance issues. Finally, the study can act as a strategic tool for players in the industry thus creating a culture of poor governance having impacts on quality audit and organizational success in the dynamic banking sector.

1.6 Scope of the Study

This study aimed to assess the effects of CG on the AQ of players within the banking industry listed on NSE. The study investigated the impact of various elements of CG adopted by commercial banks who are key players within the banking industry listed on NSE on AQ and their subsequent effect. Key Financial reports of the players running from 2018 to 2022 were investigated together with secondary scholarly studies on the companies to investigate the various aspects of the study research questions.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter reviews data collected from articles on areas relating to the research problem, both empirically and theoretically. It covers what various scholars have studied and written about elements of CG, theories supporting CG, and their effect on the AQ of companies listed at NSE.

2.2 Theoretical Framework

This study is explained with the aid of the following theories: Stewardship theory, Agency theory, and Stakeholder theory. These theories provide knowledge and information that provides support to CG.

2.2.1 Stewardship Theory

Stewardship theory, proposed by Donaldson and Davis in 1991, posits that managers act as stewards of the firm's resources and interests on behalf of shareholders. Proponents argue that managers are inherently motivated to act in the best interests of shareholders due to their fiduciary responsibility and alignment of interests through share ownership (Donaldson & Davis, 1991). Stewardship theory asserts that managers prioritize the long-term interests of shareholders over their personal gain, emphasizing transparency, accountability, and ethical behavior in decision-making. It suggests that fostering a culture of trust and cooperation between managers and shareholders leads to improved organizational performance and sustainability (Donaldson & Davis, 1991).

Critics argue that stewardship theory oversimplifies managerial motivations, neglecting the influence of self-interest and agency conflicts. Some contend that managers may prioritize personal interests over shareholders', especially in situations where their incentives are not properly aligned with long-term shareholder value (Eisenhardt, 1989).

Despite criticisms, stewardship theory offers valuable insights into the importance of fostering a governance structure based on trust and shared goals between managers and shareholders. It highlights the significance of managerial discretion and autonomy in decision-making processes, which can contribute to organizational success under conditions of uncertainty and complexity (Donaldson & Davis, 1991).

Stewardship theory is relevant to the study as it underscores the importance of board independence and transparency in corporate governance. In investigating how managerial actions, specifically the independence of the board, impact audit quality, the study aligns with the stewardship perspective by highlighting the critical role of effective governance mechanisms in enhancing shareholder value. Board independence serves as a crucial aspect of stewardship, ensuring that managerial decisions are made in the best interests of shareholders and the organization as a whole. Therefore, by examining the relationship between board independence and audit quality, the study contributes to understanding how managerial actions can foster transparency, accountability, and ultimately, shareholder value within the corporate governance framework.

2.2.2 Stakeholder Theory

Stakeholder theory, proposed by Freeman in 1984, argues that institutions ought to consider the needs of all parties involved, comprising the community, employees, suppliers, and customers instead than concentrating only on shareholders. Proponents advocate for a broader view of corporate purpose and responsibility, emphasizing the creation of value for multiple stakeholders (Freeman, 1984). Stakeholder theory asserts that organizations should seek to balance the interests of all stakeholders and engage in activities that maximize collective welfare, rather than prioritizing the interests of shareholders alone. It emphasizes the importance of ethical decision-making, social responsibility, and sustainability in corporate governance (Freeman, 1984).

Critics of stakeholder theory argue that prioritizing the interests of multiple stakeholders may lead to conflicts and dilution of managerial focus, ultimately undermining organizational performance. They contend that maximizing shareholder wealth remains the primary objective of corporations and that stakeholder interests should be considered within this framework (Jensen, 2002). Despite criticisms, stakeholder theory provides a holistic framework for corporate governance that acknowledges the interdependence of organizations and their stakeholders. It promotes ethical behavior, long-term sustainability, and societal value creation, aligning with broader societal expectations of corporate responsibility and accountability (Freeman, 1984).

Stakeholder theory is relevant to the study as it emphasizes the importance of considering the interests of all stakeholders, including shareholders, in corporate governance practices. Stakeholder theory posits that organizations should consider the interests of all stakeholders, including shareholders, employees, customers, and the community, in their decision-making processes and corporate governance practices. In exploring how governance practices influence audit quality, the study aligns with the stakeholder perspective by recognizing that effective governance not only enhances shareholder value but also contributes to broader societal welfare and organizational sustainability. Board diversity ensures diverse perspectives are considered in decision-making, reflecting the interests of various stakeholders, while compensation reviews promote fairness and accountability, addressing stakeholder concerns about executive remuneration. Thus, by examining the relationship between these governance practices and audit quality, the study contributes to understanding how organizations can fulfill their responsibilities to all stakeholders and achieve long-term sustainability.

2.2.3 Agency Theory

The need to consider board independence as a variable in this study will be informed by the proposition of the Agency Theory. Agency Theory, which was created in 1976 by Jensen and Meckling (Payne & Petrenko, 2019), examines the principal-agent interaction in organizations. Based on the agency theory a conflict of interest arises between principals and their agents due to the divergent goals they possess. Due to divergent interests, managers may seek to champion their interests in the activities of the board which may not mirror the interests of shareholders that are geared towards increasing corporate value. Most of the time the different interests by shareholders and managers overlap and have the potential of interfering in the activities of the board leading to compromise which hinders the quality of audit reports that are given where the managers have a strong influence on the board. From the agency theory angle, creating an independent audit board is likely to guarantee the quality of audit report prepared by the board.

It is critical to consider the relationship between board independence and audit quality considering the agency challenge between managers and shareholders. The agency challenge highlights the likelihood of the audit board being compromised by managers to report a misleading position about a firm. Hence, to reduce the probability of the risk of the board being compromised it is essential to have an independent board. Instituting an independent audit board ensures that the board observes openness and is accountable in the financial reporting and auditing processes. Openness and accountability in the preparation and reporting of the financial statements ensures that a high audit quality is maintained.

Given the underlying conflicts that have been outlined by Agency Theory, then proper implementation of mechanisms for monitoring becomes paramount. Guluma et al.,2021 in his study explains that, without the proper checks and balances, there might be latitude for managers to pursue actions that serve their self-interests in a manner that compromises the

prosperity of the organization. Similar monitoring systems such as board oversight bring managerial behaviors in line with shareholder objectives and even protecting against agency problems. From the studies by Vargas-Hernández, (2018) viewpoints in the corporate governance, the board of directors have been considered as a significant mechanism of monitoring that has been prescribed by Agency Theory. The board represents shareholders in matters of delegation, ensuring that decisions made by managers endorse the long-term interest of the company.

The fiduciary duty illuminates the significance of the board in reducing information asymmetry and protecting shareholders from agency conflicts through board independence. Effective board oversight is an overview that not only monitors the day-to-day operations of the company but also engages actively in the formulation of strategic decisions. In fact, various empirical studies have lent support to the basic tenets of Agency Theory. Designing executive remuneration packages with long-term performance metrics can be a disincentive for short-termism and infuse value creation, which an effective board can augment. For example, Fama and Jensen (1983), in their research work and studied facts, proved that active and independent boards of corporate directors foster stronger financial performance of companies. Similarly, Payne and Petrenko (2019) state that board independence works as a tool for agency problem remoteness and escalation of the firm value. Real-world corporate scandals and governance failures only serve to underscore the relevance of the Agency Theory. Cases such as Enron and WorldCom are a proof to the fact that an independent board is important because a failure to institute an independent board in the companies resulted in devastating consequences for shareholders and the larger economy.

Although the agency offers a basis for appreciating the centrality of an independent board to the audit processes, it is not without its criticism. The theory oversimplifies human behavior and assumes a universal degree of opportunism among people. Another central

criticism to the theory is that its emphasis on an independent board with the aim of mitigating the chances of managers influence on the board may limit the creativity and innovativeness of the manager.

2.3 Empirical Review

2.3.1 Board Independence and Audit Quality

Different studies have been performed to investigate the relationship between board independence and audit quality. With a focus on Saudi Arabia, Alqahtani (2021), evaluated the effect of board independence on audit quality. A mixed-methods strategy was used in this investigation. It involved quantitative analysis of financial data and qualitative discussions with important stakeholders. Regression analysis was utilized in the quantitative section to evaluate the connection between audit quality and board independence. In contrast to Western contexts, Alqahtani (2021) found a positive but marginally lower relationship between board independence and audit quality in the Chinese context. He determined that institutional and cultural factors have a big impact on this relationship. Although the study offers significant insight on board independence and audit quality, its insights may not reflect the reality of audits on commercial banks at NSE in Kenya which is a different context.

A study carried out by Saidu & Aifuwa (2020) investigated the relationship between board independence and audit quality of listed manufacturing firms in Nigeria. Regression analysis was utilized to look at the connection between several audit quality metrics and the percentage of independent directors on the board. Board independence and audit quality was established to have a favorable association, according to the study. It was established that companies with more independent directors had better financial reporting standards and were less likely to make financial misstatements. When the study offers insights to the relationship between audit quality and board independence, it employed a multi-method quantitative

research design which necessitates a new methodological approach such as a qualitative approach to help verify the study's outcome.

Ibrahim et al. (2019) looked at the connection between board independence and audit quality in relation to how they impact financial performance in Kenya. Using a quantitative methodology, the study examined data from data retrieved from audited financial reports of year 2017. Regression analysis was used to examine how board independence affected audit quality metrics. In their study Ibrahim et al. (2019), found a substantial positive link between board independence and financial performance of insurance firms. Although, the study is contextualized in Kenya, its focus was on insurance firms which may not reflect the reality of banking sector in Kenya.

Othman et al. (2011) studied the effect of board impartiality on financial reporting quality, focusing on Malaysian market. The study aimed to examine the relationship between board independence and the quality of financial reporting in the Malaysian market. The study utilized a sample of 100 Malaysian listed companies and employed regression analysis to investigate the impact of board independence on financial reporting quality, measured by discretionary accruals. The results indicated a positive relationship between board independence and financial reporting quality, suggesting that companies with a higher proportion of independent directors tend to exhibit lower levels of earnings management. While the study provides insights into the relationship between board independence and financial reporting quality in the Malaysian context, it does not specifically focus on the banking industry. Moreover, the study does not explore potential mechanisms through which board independence influences financial reporting quality.

In a comparative analysis between Islamic and conventional banks, Zulkafli et al. (2017) studied corporate governance and audit quality in the banking industry. This study aimed to compare the impact of corporate governance mechanisms, including board

independence, on audit quality between Islamic and conventional banks. The study analyzed a sample of 50 Islamic banks and 50 conventional banks using multiple regression analysis to assess the relationship between corporate governance mechanisms and audit quality, measured by audit fees. The results revealed that board independence positively influences audit quality in both Islamic and conventional banks. However, the effect was found to be more significant in conventional banks compared to Islamic banks. Although the study provides insights into the impact of board independence on audit quality in the banking industry, it does not delve deeply into the specific mechanisms through which board independence affects audit quality, nor does it explore potential differences between different types of banks beyond Islamic and conventional categorizations.

Al-Najjar et al. (2019) studied board independence, audit quality, and firm performance: evidence from Jordan. This study aimed to investigate the relationship between board independence, audit quality, and firm performance in the Jordanian context. The study utilized a sample of 100 Jordanian listed companies and employed regression analysis to examine the impact of board independence on audit quality, measured by discretionary accruals, and firm performance, measured by ROA. The results indicated a positive association between board independence and both audit quality and firm performance, suggesting that companies with more independent boards tend to have higher audit quality and better financial performance. While the study provides valuable insights into the relationship between board independence, audit quality, and firm performance, it focuses on the Jordanian context and does not specifically analyze the banking industry.

Uwuigbe et al. (2015) studied the impact of board independence on audit quality focusing on UK Listed Firms. This study aimed to examine the impact of board independence on audit quality in UK listed firms. The study utilized a sample of 200 UK listed firms and employed regression analysis to investigate the relationship between board independence and

audit quality, measured by the absolute value of discretionary accruals. The results revealed a positive relationship between board independence and audit quality, indicating that firms with more independent boards tend to exhibit higher audit quality. While the study provides insights into the relationship between board independence and audit quality in the UK context, it does not specifically focus on the banking industry. Additionally, the study does not explore potential mechanisms through which board independence influences audit quality.

Al-Dhamari et al. (2020) studied corporate governance and financial performance of banks with evidence from Gulf Cooperation Council (GCC) Countries. This study aimed to investigate the relationship between corporate governance mechanisms, including board independence, and the financial performance of banks in GCC countries. The study analyzed a sample of 60 banks from GCC countries and employed regression analysis to assess the impact of corporate governance mechanisms on financial performance, measured by ROE. The results indicated a positive association between board independence and financial performance, suggesting that banks with more independent boards tend to achieve better financial results. While the study provides insights into the relationship between board independence and financial performance in GCC banks, it does not specifically focus on audit quality. Additionally, the study does not explore potential differences in the impact of board independence between different countries within the GCC region.

2.3.2 Board Diversity and Audit Quality

Past studies on governance have also examined the connection between board diversity performance outcomes. For instance, Adams and Ferreira (2009), investigated “Women in the boardroom and their impact on governance and performance.” The study was conducted on 1,939 firms in the United States. The authors used regression analysis in the study. The study established that gender-diverse boards were linked to more effort towards monitoring.

(Adams & Ferreira, 2009). The study findings suggest a likely improved audit quality from a diverse board. However, this evidence on likely audit quality arising from board diversity from Adams and Ferreira (2009), study needs further investigation by considering other contexts because it was carried out on firms in America.

In a recent study, Chijoke-Mgbame et al. (2020) investigated how gender diversity influences effectiveness of audit committees. The researchers applied panel regression methodology on 77 firms, together with regression analysis, while examining the data. According to the authors a representation of female members on the board committee results in firm's improved financial performance which suggest better audit quality from such diverse boards. In this regard, the findings of the study established a positive relationship between higher proportions of female directors in boards and effective control of financial reporting quality. Findings indicated that more diverse boards particularly involving increased gender diversity tend to be in support of vigilance and a responsive environment on financial oversight (Chijoke-Mgbame et al., 2020). However, the author used data from Bloomberg company which operates in the media industry whose reality may not reflect the reality of the banking sector.

More recent studies have broadened the definition of board diversity beyond gender and now take expertise, age, and ethnicity into account. For instance, Anyuki et al. (2023) examined how board diversity affected Kenya universities efficiency. The authors employed a descriptive longitudinal research design. In their investigation, they found that more diverse university boards in Kenya resulted in university operations efficiency. The resulting operation efficiency from Kenyan universities board diversity point to the potential of board diversity leading to higher audit quality. However, the study's findings cannot be generalized to audit because the study was focused on operational efficiency and not audit quality. Hence,

is study focused on board diversity and audit quality focused on commercial banks listed at NSE is critical.

Smith et al. (2016) studied board diversity and financial reporting quality using evidence from UK Banks. The study aimed to investigate the relationship between board diversity and financial reporting quality in UK banks. A sample of 50 UK banks was analyzed using regression analysis to examine the impact of board diversity, measured by gender and ethnicity diversity, on financial reporting quality, measured by earnings management. The study found a positive association between board diversity and financial reporting quality, indicating that banks with more diverse boards tend to exhibit lower levels of earnings management. While the study provides valuable insights into the relationship between board diversity and financial reporting quality in UK banks, it does not explore potential differences across different types of banks or consider other dimensions of diversity beyond gender and ethnicity.

García-Meca et al. (2018) studied diversity in the boardroom and financial performance with evidence from European banks. This study aimed to examine the impact of board diversity on financial performance in European banks. The study analyzed a sample of 100 European banks and employed regression analysis to assess the relationship between board diversity, measured by gender, age, and educational background diversity, and financial performance, measured by ROA. The results revealed a positive association between board diversity and financial performance, suggesting that banks with more diverse boards tend to achieve better financial results. Although the study provides insights into the relationship between board diversity and financial performance in European banks, it does not specifically focus on audit quality or consider potential differences in the impact of diversity across different regions within Europe.

Al-Matari et al. (2019) studied the impact of board diversity on bank performance in the Middle East. This study aimed to investigate the relationship between board diversity and bank performance in the Middle East region. A sample of 60 banks from Middle Eastern countries was analyzed using regression analysis to examine the impact of board diversity, measured by gender and nationality diversity, on bank performance, measured by ROE. The study found a positive association between board diversity and bank performance, indicating that banks with more diverse boards tend to achieve higher returns on equity. While the study provides insights into the relationship between board diversity and bank performance in the Middle East, it does not specifically focus on audit quality or explore potential mechanisms through which diversity influences bank performance.

Chen et al. (2017) explored board diversity and bank risk taking among Asian banks". The study aimed to examine the impact of board diversity on bank risk-taking behavior in Asian banks. The study analyzed a sample of 80 Asian banks and employed regression analysis to assess the relationship between board diversity, measured by gender, age, and educational background diversity, and bank risk-taking, measured by loan loss provisions. The results indicated a negative association between board diversity and bank risk-taking, suggesting that banks with more diverse boards tend to exhibit lower levels of risk-taking behavior. Although the study provides insights into the relationship between board diversity and bank risk-taking in Asian banks, it does not specifically focus on audit quality or consider potential differences in the impact of diversity across different banking markets within Asia.

Ahmed et al. (2020) studied gender diversity and financial performance of banks from Emerging markets. This study aimed to investigate the relationship between gender diversity on boards and financial performance in banks from emerging markets. The study analyzed a sample of 70 banks from emerging markets and employed regression analysis to examine the impact of gender diversity on boards, measured by the proportion of female directors, on

financial performance, measured by ROE. The results revealed a positive association between gender diversity on boards and financial performance, indicating that banks with a higher proportion of female directors tend to achieve better returns on equity. While the study provides insights into the relationship between gender diversity and financial performance in banks from emerging markets, it does not specifically focus on audit quality or explore potential mechanisms through which gender diversity influences financial performance.

2.3.3 Board Compensation Reviews and Audit Quality

Early studies primarily aimed to develop a theoretical foundation for the association between board compensation reviews and audit quality. For instance, Engel, Hayes, & Wang (2010) carried out a groundbreaking study in the United States to investigate the effect of the effectiveness of the pay-on-board committee financial reporting monitoring. The study, established that one audit board members compensation critically impacts audit quality and that members should be compensated based on their expertise. The study emphasizes the value of thorough compensation review procedures to ensure matching board members compensation to their expertise. However, the findings of the study cannot be generalized to companies operating within the banking sector in Kenya since it was performed in America.

Besides, studies have examined the empirical relationship between board compensation reviews and audit quality, building on this theoretical framework. For instance, Chandar, Chang, & Zheng (2008) used regression analysis methods to carry out a thorough investigation of non-financial S&P 500 companies. According to their research, there is a link between audit quality and how frequently the pay committee meets. The idea that active pay committees are essential in improving financial reporting quality was validated by this empirical evidence, which also emphasized the significance of board compensation evaluations. However, the study focused on non-financial companies which makes investigating the study on financial companies such as banks critical.

More complex facets of board compensation reviews and their effects on audit quality are now being explored in recent studies in this field. For instance, Komal, Ye, & Salem (2022) carried out research in China using a mixed-methods strategy that included quantitative analysis with surveys and interviews. Their findings revealed that audit quality was favorably correlated with the independence of the pay committee. By highlighting the universal applicability of the connection between board compensation evaluations and audit quality, this study showed that these dynamics are not exclusive to Western corporate settings.

Lee et al. (2018) studied Board Compensation and Audit Quality among US Bank Holding Companies. The study aimed to examine the relationship between Board Compensation and audit quality in US bank holding companies. A sample of 100 US bank holding companies was analyzed using regression analysis to investigate the impact of Board Compensation, including the proportion of independent directors and financial experts, on audit quality, measured by the likelihood of financial restatements. The results indicated a positive association between Board Compensation and audit quality, suggesting that companies with a higher proportion of independent directors and financial experts on their boards tend to have lower rates of financial restatements. While the study provides valuable insights into the relationship between Board Compensation and audit quality in US bank holding companies, it does not explore potential differences across different sizes or types of banks, nor does it consider the influence of other board characteristics beyond independence and financial expertise.

Müller et al. (2019) studied the impact of Board Compensation on audit quality with evidence from European banks. This study aimed to investigate the impact of Board Compensation on audit quality in European banks. The study analyzed a sample of 150 European banks and employed regression analysis to assess the relationship between Board

Compensation, including the diversity of skills and experiences, and audit quality, measured by the likelihood of audit failures. The results revealed a positive association between Board Compensation and audit quality, indicating that banks with more diverse boards in terms of skills and experiences tend to experience fewer audit failures. Although the study provides insights into the relationship between Board Compensation and audit quality in European banks, it does not specifically focus on the mechanisms through which Board Compensation influences audit quality, nor does it consider potential differences across different regulatory environments within Europe.

Rodríguez et al. (2020) examined Board Compensation and audit quality in emerging markets with a focus on Latin American Banks. This study aimed to examine the relationship between Board Compensation and audit quality in Latin American banks. A sample of 80 Latin American banks was analyzed using regression analysis to investigate the impact of Board Compensation, including the proportion of independent directors and financial experts, on audit quality, measured by the accuracy of financial reporting. The results indicated a positive association between Board Compensation and audit quality, suggesting that banks with more independent directors and financial experts on their boards tend to have more accurate financial reporting. While the study provides insights into the relationship between Board Compensation and audit quality in Latin American banks, it does not explore potential cultural or institutional factors that may influence this relationship, nor does it consider the influence of other board characteristics beyond independence and financial expertise.

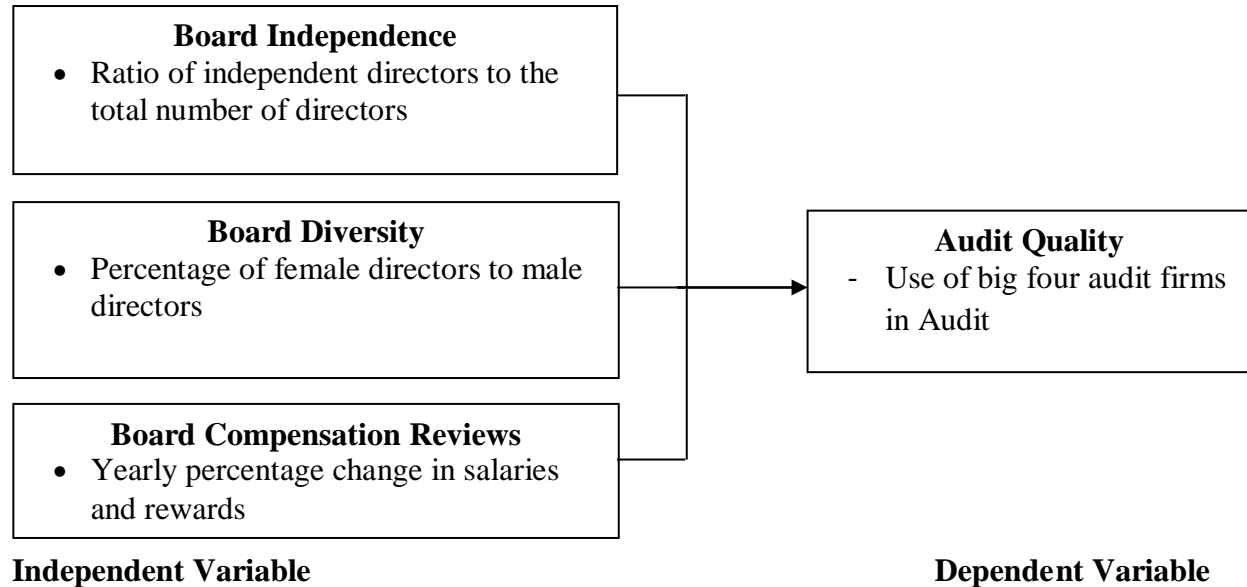
Tan et al. (2017) studied corporate governance and audit quality in Asian banks focusing on the role of board diversity. This study aimed to investigate the role of board diversity in the relationship between corporate governance and audit quality in Asian banks. The study analyzed a sample of 120 Asian banks and employed structural equation modeling to assess the mediating effect of board diversity on the relationship between corporate

governance mechanisms, including board independence and financial expertise, and audit quality, measured by the likelihood of audit adjustments. The results indicated that board diversity mediates the relationship between corporate governance mechanisms and audit quality in Asian banks, suggesting that a more diverse board enhances the effectiveness of corporate governance practices in improving audit quality. Although the study provides insights into the mediating role of board diversity in the relationship between corporate governance and audit quality in Asian banks, it does not specifically focus on the direct impact of Board Compensation on audit quality or explore potential differences across different regions within Asia.

Ngugi et al. (2018) studied Board Compensation and Financial Reporting Quality, focusing on African banks. This study aimed to examine the relationship between Board Compensation and financial reporting quality in African banks. A sample of 70 African banks was analyzed using regression analysis to investigate the impact of Board Compensation, including the proportion of independent directors and financial experts, on financial reporting quality, measured by the accuracy of financial statements. The results indicated a positive association between Board Compensation and financial reporting quality, suggesting that banks with more independent directors and financial experts on their boards tend to have more accurate financial reporting. While the study provides insights into the relationship between Board Compensation and financial reporting quality in African banks, it does not specifically focus on audit quality or explore potential differences across different regions or regulatory environments within Africa.

2.4 Conceptual Framework

FIGURE 1
Conceptual Framework



Source: Author (2024)

2.5 Operationalization of Variables

The operationalization of the research's variables will define and quantify the key ideas being studied and how they will be measured.

Board Independence

Board independence was operationalized through the assessment of commercial banks board independent directors. To achieve this, the study analyzed the companies' proxy statements and annual reports. The directors to be considered independent are those who had no material relationships with the organization apart from being directors to the company. The more an audit board has members qualifying as independent members the more the board is considered to be independent. The yardstick of identifying the independent directors is those individuals who have no material affiliations or links with the concerned banks apart from being the directors of these banks. Basically, the evaluation seeks to determine if there was independence on the part of the members of a board to find out whether their activities and

decisions are not influenced by any undue pressure or from any interest that may limit their capacity to remain objective.

Board Diversity

This was put into operation in the study by calculating the diversity of the members of the board of directors of commercial banks listed on NSE based on factors like nominations of male and female directors, gender, age, ethnicity, educational attainment, and professional experience. A diverse board, for instance, might have members who represent various demographics and have distinct skill levels. A board that had various distinct aspects in terms of demographics, educational attainment, and experience was held as a more diverse board.

Board Compensation Reviews

Indexing Board Compensation Review is among the most significant corporate governance methods that an organization can utilize in other words transparency, accountability, and effectiveness to become noticeable in leadership structure. This paper critically analyzed remuneration policies of leading commercial banks listed at NSE. Through an exploratory methodology, this work commendably established if commercial banks do periodic board remuneration packages evaluation. To discover compensation review patterns, trends, and the underlying rationales that influenced modifications in board pay, the study did investigate board members yearly percentage increase in salaries and rewards in relation to the members roles or performance, professional experience, and educational attainment.

Audit Quality (Financial Reporting and Error Detection)

Metrics such as the frequency of restatements or revisions in financial statements, the incidence of serious misstatements, or external auditor evaluations of the company's financial reporting dependability was considered as key indicators of audit quality. For instance, many

instances of material misstatement, failure in timely preparation of financial reports demonstrated poor audit quality.

TABLE 1

Operationalization of Variables

Variables Type	Variable	Indicator	Specific Measure	Scale
Independent Variable	Board Independence	Independent directors	Ratio of independent directors to the total directors.	Ratio
	Board diversity	Gender diversity	Percentage of female directors to male directors	Ratio
	Board compensation reviews	Salaries and rewards	Yearly percentage change in salaries and rewards	Ratio
Dependent variable	Audit Quality	Audit firm	Use of big four audit firms	Binary

Source: Author (2024)

2.6 Summary of Literature Review

The Literature review consists of theories that explain CG at an in-depth analysis. These theories include stewardship theory, stakeholder theory, and Agency theory (Jensen and Meckling 1976). Most of the studies conducted focus on financial performance as an output of CG. They highlight some attributes of CG and their relation to financial performance.

According to the literature review, Sound CG practices contribute to the financial performance of an organization. Some local studies concentrated on one component of CG in relation to financial performance and investment efficiency. The analysis of each element of CG provides insights into the benefits of incorporating all the elements to achieve AQ as they pose a significant impact. It is evident that Studies conducted on AQ have a focus on

other countries other than Kenya. This study will therefore contribute towards filling that gap.

CHAPTER THREE

METHODOLOGY

3.1 Introduction

This chapter describe the research approach that was used in investigating the effect of corporate governance on the audit quality of Listed commercial banks at NSE. Key research questions addressed through this research methodology are: Does board Independence have an effect on audit quality of commercial banks listed at NSE? Does board diversity have an effect on audit quality of commercial banks listed at NSE? Do board compensation reviews have an effect on audit quality of commercial banks listed at NSE? In order to answer the research questions and accomplish the goals of the study, it adopted a precise framework for the data collection, analysis, and interpretation processes. The target population, sample strategy, data collection tool, validity and reliability metrics, and ethical considerations are all described in this section.

3.2 Research Design

A research design is critical to any study as it demonstrates the approach used in performing a study to ensure the research objectives are attained. The quantitative technique was critical to this study because it was used in handling numerical data obtained from the financial reports and help investigate the board compensation reviews variable which involved calculating percentage salaries and rewards increments based on performance. This study systematically reviewed the commercial bank's past board papers history, financial report histories and companies' annual reports for the commercial banks listed at NSE for the period between 2018 and 2022. The research, by emphasizing a systematically review design, intended to investigate comprehensively the effect of corporate governance factors such as board independence, board diversity, as well as, board compensation reviews have on audit quality

of commercial banks listed at NSE. Through this design, trends and patterns were analyzed in detail to provide insights into the research questions.

3.3 Target Population

The target population for this study was the 12 commercial banks firms listed at the NSE. The selection of commercial banks as the target population for this study is scientifically justified due to their unique role and significance within the financial sector. Commercial banks play a central role in the economy by intermediating funds between savers and borrowers, facilitating economic growth and stability (Kashyap et al., 2002). Moreover, banks are subject to stringent regulatory oversight and governance requirements due to the systemic risks they pose to the financial system (Barth et al., 2016). As key institutions within the capital market, banks' financial reporting and audit quality are critical for maintaining investor confidence and market integrity (Zhang et al., 2019). Additionally, the banking sector often faces specific challenges related to corporate governance and audit quality, such as conflicts of interest, risk management, and regulatory compliance (Ntim et al., 2015). Therefore, studying corporate governance and audit quality within commercial banks provides valuable insights into broader issues of financial stability, transparency, and accountability within the capital market ecosystem.

3.4 Sampling Procedure and Sample Size

A census of all 12 banks was conducted, to ensure comprehensive coverage of the target population, thereby enhancing the generalizability and representativeness of the study findings (Babbie, 2016). In including all banks, the study minimized sampling bias and increases the validity of the results, as it captures the entire population of interest without excluding any relevant cases (Creswell & Creswell, 2017). This approach enables a thorough examination of the relationships between corporate governance, audit quality, and firm

performance within the banking sector, providing robust insights for policymakers, regulators, and practitioners (Hair et al., 2018). Additionally, a census approach eliminates the need for inferential statistics and allows for more precise estimates of population parameters, enhancing the reliability of the study outcomes (Fink, 2019).

3.5 Data Collection Instrument

The data collection approach for this study was the use of systematic review of reports and company documents from the sample of commercial banks listed in the NSE between the tracking period 2018 to 2022 was done. Using systemic review of past documents was considered by this study because of its ability to eliminate the risk of subjectiveness that comes with primary data collection instruments. The main sources of data included board papers, financial reports and annual company reports of the selected banks. Such documents provided enough information pertaining to the corporate governance practice under review from the board independence, diversity, and compensation review to overall financial performance and quality of audit. In this approach, key documents were looked at and an exhaustive review was done.

Board papers were looked into with regards to decision making processes, governance structures and any documents relating to discussions or resolutions in relation to audit quality made within the stipulated years. From the financial reports, there was a financial analysis to aid in understanding the financial health of the banks and establish whether there is any correlation between the financial performance and governance practices. The annual company reports would provide an overview of the existing corporate governance mechanisms including policies and procedures that are likely to affect audit quality.

Critical data gained from the reviewed documents was recorded on a Microsoft Word document. The word document was structured in a table format with columns and rows. The

Columns were labeled based on the independent variables of the study while the rows had the indicators identified in the reviewed documents. The use of the word document tool helped guide the systematic review of the documents which enabled identification and extraction of relevant information with respect to board independence, diversity, compensation reviews and impact on audit quality.

3.6 Data Collection Procedure

The data collection procedure for this study involved gathering secondary data, specifically financial statements and reports, from the 12 commercial banks listed at the NSE. Secondary data collection methods were employed as they provide a wealth of pre-existing information that is readily accessible and relevant to the study objectives (Saunders et al., 2018). Financial statements and reports are comprehensive documents that contain vital information on corporate governance practices, audit quality, and firm performance, making them suitable sources for investigating the research variables (Cooper & Schindler, 2019). The researcher obtained these documents from reliable sources such as the NSE website, annual reports published by the banks, and regulatory filings submitted to the Capital Markets Authority (CMA) in Kenya (Bryman & Bell, 2019). Using secondary data not only ensured the efficiency of data collection but also minimized potential biases associated with self-reporting or survey responses (Bryman, 2016).

3.7 Data Analysis

Deciding on the appropriate method for data analysis is significant when conducting research. A proper method for research data analysis ensures that proper insight is gained from the collected data to inform the research findings. A good data analysis method must take into account the nature of data that is collected during the study. In this study secondary data that was gained from the various financial reports was coded to allow for the application of

statistical analysis to it. In this study, given that the dependent variable, Audit Quality, is binary, indicating two possible outcomes, a logistic regression analysis should be conducted. Logistic regression is a statistical method used for analyzing binary outcome variables, making it suitable for modeling the relationship between a binary dependent variable and one or more independent variables. Logistic regression allows for the prediction of the probability of occurrence of an event, making it appropriate for binary outcomes such as audit quality in this study (Hosmer et al., 2013).

Each specific objective in this study was investigated by applying statistical tests:

- i. Effect of Board Independence on Audit Quality: In investigating the Effect of Board Independence on Audit Quality, multiple regression analysis was adopted by this study. The analysis considered any potential confounding variables.
- ii. Effect of Board Diversity on Audit Quality: The study ran a regression analysis to see how board diversity affects audit quality. This analysis took into consideration any moderating factors.
- iii. Effect of Board Compensation Reviews on Audit Quality: Regression analysis was used to investigate how board compensation reviews affect quality of audit. This analysis considered any variables that interact.

The regression equation is as follows:

Model Equation:

$$\text{Logit}(P) = \ln\left(\frac{P}{1-P}\right) = \beta_0 + \beta_1\text{BoardInd} + \beta_2\text{BoardDiv} + \beta_3\text{BoardComp}$$

Where:

P = Probability of high audit quality (dependent variable).

β_0 = Regression Constant

β_1 to β_3 = Regression Coefficients

BoardInd = Board Independence

BoardDiv = Board Diversity

BoardComp = Board compensation reviews

The data analysis findings were organized and presented in an understandable format. Graphs, tables, and charts were used in the analysis to show the regression coefficients, significant findings, and descriptive statistics.

3.8 Research Ethics

Observing ethics is an important requirement in performing any research as it adds to the quality and value of the study. Hence, this study approach prioritized ethical considerations as a matter of utmost significance. All operations pertaining to the collecting, analysis, and reporting of data were carried out in adherence to recognized ethical rules and principles. Informed consent (Nagar, 2021), was sought from respective leaders for access to private financial documents and measures were taken to ensure the strict maintenance of their confidentiality and anonymity. Complying with the principles of beneficence, non-maleficence, and justice, was also an important ethical consideration in this study. The study guaranteed the welfare and rights of the various institutions whose documents were considered in this research by storing the documents in a safe laptop with strong password.

3.9 Diagnostic Tests

Diagnostic tests are important to any study as they help in investigating assumptions and highlighting problems within a research data. In this study various diagnostic tests were performed. The tests aimed at ensuring that the study assumptions and likely problems in the collected data are spotted and eliminated to help add to the quality of the study findings. Below are the diagnostic tests that were considered in this study:

3.9.1 Multicollinearity

Multicollinearity, in a multivariate regression model, test for a strong intercorrelations between two or more independent variables (Kim, 2019). Multicollinearity is established where independent variables have a strong correlation. The lack of independence in data with multicollinearity makes it tough to analyze. In this study, testing for multicollinearity was significant to establish the independence of the independent variables. The study calculated Variance inflation factors (VIFs) for each independent variable to test for multicollinearity. In this study, VIF values beyond ten would suggest a correlation among the independent variables. Testing for multicollinearity in this study was important to guarantee predictor variables' independence.

3.9.2 Heteroscedasticity

Heteroscedasticity is employed to describe a regular change in the remainders' dispersal across the measured spectrum (Alabi et al., 2020). Heteroscedasticity is troublesome because ordinary least squares (OLS) regression assumes that all remainders come from an assortment with an equal variance (homoscedasticity). In this study, scatterplots of residuals against predicted values were analyzed to identify heteroscedasticity. Confirmation of heteroscedasticity is vital to this study because it verifies residual variance consistency.

3.9.3 Goodness-of-Fit Test

The study conducted the Hosmer-Lemeshow test to assess if, in certain model population subgroups, the observed event rates correspond to the anticipated occurrence rates. A non-significant result (p-value > 0.05) indicates a good fit.

3.9.4 Test for Outliers

The study employed the Mahalanobis distance test to identify potential outliers within the dataset. This statistical test measures the distance of each observation from the mean of the

predictor variables, considering the correlations between them. In examining the Mahalanobis distances, the study aimed to ensure the robustness of the analysis and the accuracy of the regression model. The results of the Mahalanobis distance test would indicate that there are no outliers in the dataset if no item has a probability values below 0.0001, suggesting that all observations conform well to the expected patterns and distributions without significantly deviating from the norm.

3.9.5 Linearity of Logit

This test assessed the assumption that the logit (log-odds) of the outcome is linearly related to the continuous predictors by including interaction terms between the main predictors (BoardInd, BoardDiv, BComp) and their corresponding log-transformed versions (LN_BI, LN_BD, LN_BC).

3.9.6 Autocorrelation

The degree of resemblance or correlation between neighboring observations is known as autocorrelation (Elsayir, 2019). Spatial autocorrelation measures a variable's spatially mediated relationship with itself, and it can be either positive or negative. Positive spatial autocorrelation happens when undetectable values occur close to one another, and negative spatial autocorrelation happens when distinguishable values occur close to one another. In this study, measuring autocorrelation was essential since the study considered the companies' time-series data from financial reports. The Durbin-Watson statistic was used in autocorrelation detection where values near 2 would denote the absence of autocorrelation.

3.9.7 Hausman Test of Random or Fixed Effect

The study conducted a Hausman Test to determine whether to employ random effects or fixed effects in the analysis. The choice between random effects and fixed effects models is crucial in panel data analysis as it affects the interpretation and validity of the results (Greene,

2012). If the null hypothesis of no systematic difference between the coefficients of the random effects and fixed effects models is rejected, indicating that the coefficients are correlated with the explanatory variables, the fixed effects model is preferred as it provides consistent estimates (Wooldridge, 2010).

CHAPTER FOUR

DATA ANALYSIS AND DISCUSSION

4.1 Introduction

This Chapter provides a comprehensive analysis of the data collected and examines the relationships between the determinant and resultant variables in the study. It is structured into five sections, beginning with descriptive statistics which offers a detailed overview of the main characteristics of the data, focusing on measures of central tendencies and dispersion. Preliminary diagnostic tests are then conducted, with a focus on multicollinearity, heteroskedasticity and autocorrelation. A correlation analysis is then performed, investigating the strength and direction of relationships between variables, followed by regression analysis which delves deeper into exploring the influence of independent variables on the dependent variable, offering insights into the predictive power and significance of various factors. The chapter culminates in the discussion of findings in relation to previous studies, highlighting areas of both convergence and contrast.

4.2 Descriptive Statistics

The Descriptive Statistics section presents a summary of key characteristics for the four variables under study: Audit Quality, Board Independence, Board Diversity, and Board Compensation. This section offers insights into the range of values observed for each variable, including minimum and maximum values, providing context on the variability within the dataset. Additionally, it presents measures of central tendency such as the mean, offering a glimpse into the typical value for each variable, while standard deviations highlight the dispersion or variability of the data around the mean. By elucidating these fundamental statistical metrics, the Descriptive Statistics section sets the stage for further analysis, offering a clear snapshot of the dataset's distribution and characteristics.

Audit quality was treated as a dummy variable, with 1 indicating use of any of the 'Big Four' auditors, and 0 indicating none-use for the 5-year period, across the respective commercial banks. As presented, a mean of 0.7 was established, indicating great extent of use of the 'Big Four' auditors, across the commercial banks. From the results on Table 4.1, the minimum value is 0, indicating that in at least one instance, a commercial bank did not engage any of the 'Big Four' audit firms during the observed period. This signifies that some banks opted for smaller, non-Big Four audit firms for their audit services. The maximum value is 1, which signifies that in some instances, commercial banks did engage the services of one of the 'Big Four' audit firms. The dichotomous nature of this variable (0 or 1) effectively captures whether or not the banks employed the services of these prominent auditors. The mean audit quality score is 0.7000. This value indicates that, on average, 70% of the commercial banks engaged the services of 'Big Four' audit firms across the 5-year period. A mean of 0.7 reflects a substantial preference for the Big Four firms (PwC, Deloitte, KPMG, and Ernst & Young) among the banks. This can be attributed to the perceived higher audit quality associated with these firms due to their international reputation, expertise, and the trust investors place in their financial reporting.

The high mean (0.7) suggests that a majority of the listed commercial banks rely on the 'Big Four' auditors. This aligns with the general expectation that larger and more established firms, such as commercial banks, are likely to use top-tier audit firms to enhance their financial credibility, satisfy regulatory requirements, and boost investor confidence. The standard deviation of 0.46212 shows there is some divergence in the choice of auditors. This could be due to several factors such as the bank's size, financial performance, audit fees, or internal corporate governance structures. Smaller banks or those facing financial constraints may opt for non-Big Four auditors to reduce costs, despite the potential trade-off in perceived audit quality. The data suggests that the majority of banks likely adhere to good corporate

governance practices, as using Big Four auditors is often associated with higher audit quality. However, the fact that some banks do not engage these auditors (evidenced by the minimum value of 0) raises questions about the consistency of audit quality across the sector, which could have implications for investor confidence and regulatory oversight.

Board independence registered a mean of .47, indicating average independence, with the average ratio of independent directors to the total number of directors being 0.473:1 (47.3%) with a standard deviation of approximately 21%. In contrast, board diversity was found to be minimal, with the percentage of female directors to male directors recording a paltry a mean ratio of 29.5%. Further, the average percentage increase in salaries and rewards was recorded at 5.45%, with a standard deviation of 1.75 years, a minimum of 2.8 years and a maximum of 9.9 years.

TABLE 2

Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
Audit Quality	60	.00	1.00	.7000	.46212
Board Independence	60	.08	.82	.4733	.20998
Board Diversity	60	.10	.50	.2950	.12865
Board Compensation	60	2.80	9.90	5.4500	1.75079

Source: Author (2024)

4.3 Preliminary Diagnostic Tests

This section encompasses essential assessments to ensure the validity and reliability of the regression model. Three tests are specifically conducted, including multicollinearity test, heteroscedasticity test and the autocorrelation test.

4.3.1 Multicollinearity Test

The Multicollinearity Test evaluates the degree of intercorrelation among independent variables, crucial for identifying potential issues of multicollinearity that could distort

coefficient estimates and undermine the model's interpretability. In this case, the Tolerance values for all independent variables are above the commonly recommended threshold of 0.1 or 0.2 (Saunders et al., 2019), suggesting low levels of multicollinearity. Additionally, the VIF values are all less than 10, which further confirms the absence of significant multicollinearity concerns (Kumar, 2018). Overall, these results indicate that the independent variables (Board Independence, Board Diversity, and Board Compensation) are relatively independent of each other, allowing for a more reliable interpretation of the regression coefficients and enhancing the validity of the regression model.

TABLE 3

Multicollinearity Test

	Tolerance	VIF
Board Independence	.140	7.118
Board Diversity	.152	6.560
Board Compensation	.100	9.473

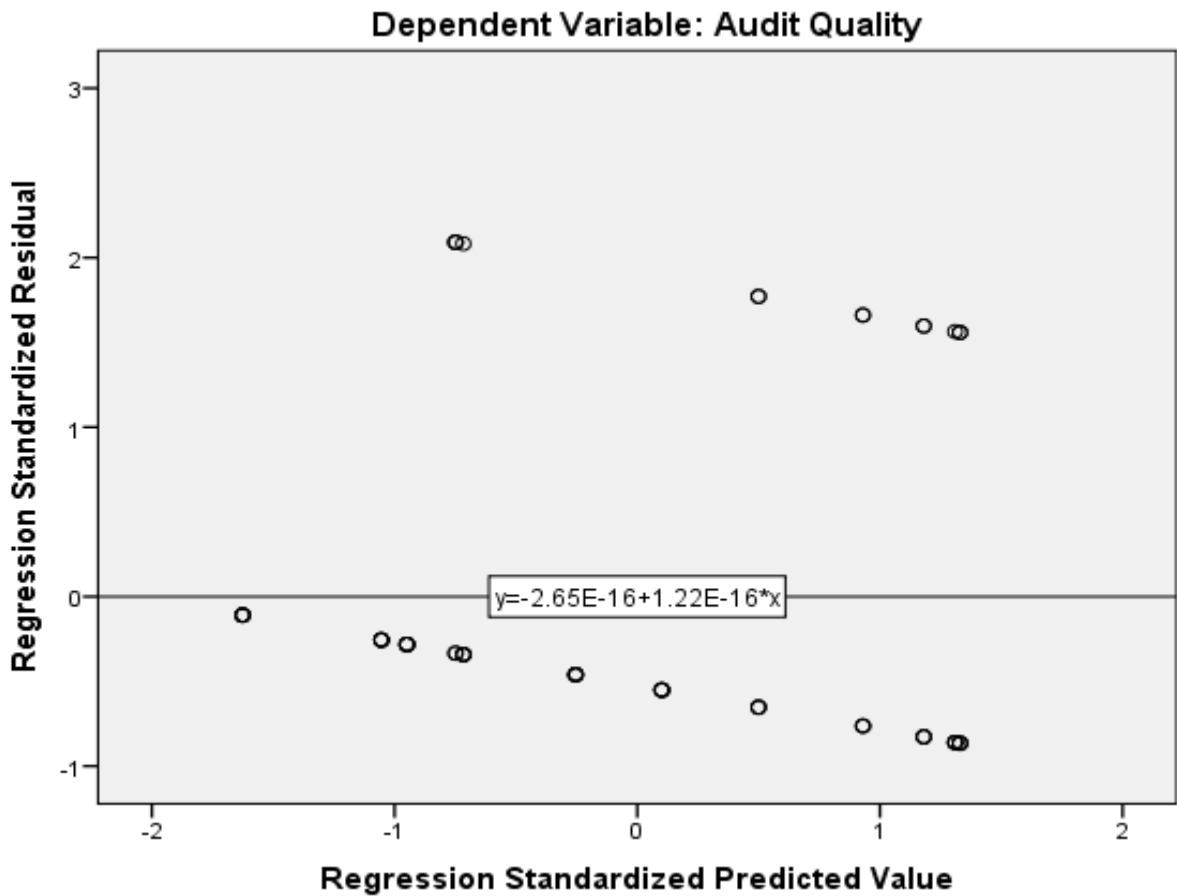
Source: Author (2024)

4.3.2 Heteroscedasticity Test

The heteroscedasticity test examines the variance of the residuals to detect any patterns of unequal variability across observations, which if present, could violate the assumption of homoscedasticity and compromise the efficiency of coefficient estimates. Figure 4.1 presents the heteroscedasticity test results.

FIGURE 2

Heteroscedasticity Test



Source: Author (2024)

The spread of the residuals was found to be consistent across the entire range of the independent variable(s). As illustrated, data points are randomly dispersed, forming a symmetric cloud shape, and there was no systematic relationship between the magnitude of residuals and the levels of the independent variable(s). As such, the assumption of homoscedasticity is met.

4.3.3 Goodness-of-Fit Test

The study conducted the Hosmer-Lemeshow test to assess if, in certain model population subgroups, the observed event rates correspond to the anticipated occurrence rates. A non-significant result ($p\text{-value} > 0.05$) indicates a good fit. As per Table 4.3, the Chi-square goodness-of-fit test results presented indicate varying levels of fit for the different variables

under investigation. For Audit Quality, the Chi-square statistic is 15.000 with 1 degree of freedom and a significance level of .000, suggesting a significant deviation from the expected frequencies, which indicates that the observed distribution significantly differs from the expected distribution.

This result implies that the variable of audit quality fits the model well with respect to its expected frequencies. In contrast, Board Independence has a Chi-square statistic of 10.200 with 38 degrees of freedom and a significance level of 1.000. This high p-value suggests no significant deviation from the expected frequencies, indicating poor fit and suggesting that the distribution of board independence does not align with the model’s expectations. Similarly, Board Diversity and Board Composition have Chi-square statistics of 8.800 and 7.333 with 15 and 19 degrees of freedom, respectively, and high p-values of .888 and .992. Both of these results also show poor fit with the expected frequencies due to the high p-values, suggesting that the distributions for board diversity and composition are not adequately represented by the model. The low expected cell frequencies in many categories for board independence, diversity, and composition further indicate issues with the model’s fit and potential data sparsity or coding issues that need to be addressed for more reliable analysis.

TABLE 4

Chi Square Goodness of Fit Test

	Audit Quality	Board Independence	Board Diversity	Board Composition
Chi-Square	15.000 ^a	10.200 ^b	8.800 ^c	7.333 ^d
df	1	38	15	19
Asymp. Sig.	.000	1.000	.888	.992

Source: Author (2024)

4.3.4 Test for Outliers

The study employed the Mahalanobis distance test to identify potential outliers within the dataset. This statistical test measures the distance of each observation from the mean of the predictor variables, considering the correlations between them. In examining the Mahalanobis distances, the study aimed to ensure the robustness of the analysis and the accuracy of the regression model. The results of the Mahalanobis distance test indicated that there were no outliers in the dataset, as no item had a probability values below 0.0001, suggesting that all observations conformed well to the expected patterns and distributions without significantly deviating from the norm. This absence of outliers supports the validity and reliability of the subsequent analysis.

The Mahalanobis distance test output table 4.4 provides several key diagnostic measures used to assess the influence of individual data points on the regression analysis. The Mahalanobis distance values range from a minimum of 0.217 to a maximum of 13.330, with a mean of 2.950 and a standard deviation of 2.261. This range of distances indicates variability in the degree to which observations are distant from the mean of the predictor variables. For detecting outliers, a common threshold is the chi-square distribution value at a specified significance level, such as 13.28 for ($P < 0.01$) with 4 predictor variables. In this dataset, while the maximum Mahalanobis distance of 13.330 is close to this threshold, it is below it, suggesting that no data points are extreme outliers. Other residuals statistics, including standardized, studentized, and Cook's distances, also suggest that the residuals are within acceptable limits, further supporting the conclusion that the data does not contain influential outliers.

TABLE 5**Residuals Statistics^a**

	Minimum	Maximum	Mean	Std. Deviation	N
Predicted Value	.7070	1.9364	1.2500	.34028	60
Std. Predicted Value	-1.596	2.017	.000	1.000	60
Standard Error of Predicted Value	.040	.138	.070	.019	60
Adjusted Predicted Value	.6865	1.9294	1.2449	.33672	60
Residual	-.55090	.48325	.00000	.27365	60
Std. Residual	-1.961	1.720	.000	.974	60
Stud. Residual	-2.047	1.779	.009	1.007	60
Deleted Residual	-.60033	.51668	.00510	.29269	60
Stud. Deleted Residual	-2.110	1.815	.007	1.017	60
Mahal. Distance	.217	13.330	2.950	2.261	60
Cook's Distance	.000	.111	.018	.023	60
Centered Leverage Value	.004	.226	.050	.038	60

a. Dependent Variable: Audit Quality

Source: Author (2024)

4.3.5 Linearity of Logit

This test assessed the assumption that the logit (log-odds) of the outcome is linearly related to the continuous predictors. Table 4.5 evaluates the linearity of the logit assumption in a logistic regression model by including interaction terms between the main predictors (BoardInd, BoardDiv, BComp) and their corresponding log-transformed versions (LN_BI, LN_BD, LN_BC). Each interaction term's coefficient is accompanied by extremely large standard errors and Wald statistics close to zero, resulting in very high p-values (all around 1.000 or 0.998). This suggests that the interaction terms do not significantly contribute to the model, indicating that the relationship between the predictors and the logit of the outcome variable is approximately linear. The very large exponential values for the interaction terms further support this finding, suggesting no substantial deviation from linearity. Consequently, the results imply that the linearity assumption for the logit in this model holds, and the predictors are adequately represented without significant non-linearity issues.

TABLE 6**Linearity Test**

	B	S.E.	Wald	df	Sig.	Exp(B)
Step 1 ^a BoardInd	-81.112	588951.965	.000	1	1.000	.000
BoardDiv	68.904	83539.416	.000	1	.999	8.4E29.000
BComp	-	78115.494	.000	1	.999	.000
	142.965					
BoardInd by LN_BI	525.861	926571.918	.000	1	1.000	2.392E+228
BoardDiv by LN_BD	45.862	431575.309	.000	1	1.000	8.2E19
BComp by LN_BC	96.468	35593.902	.000	1	.998	7.864E+41
Constant	265.864	513231.612	.000	1	1.000	2.907E+115

a. Variable(s) entered on step 1: BoardInd, BoardDiv, BComp, BoardInd * LN_BI , BoardDiv * LN_BD , BComp * LN_BC .

Source: Author (2024)

4.3.6 Autocorrelation Test

The Autocorrelation test investigates the independence of residuals over time, aiming to detect any systematic patterns of correlation that could invalidate the statistical inference drawn from the regression analysis. The Durbin-Watson statistic is a measure used to detect the presence of autocorrelation in the residuals of a regression analysis. It ranges in value from 0 to 4. A value around 2 indicates no autocorrelation, while values significantly below 2 suggest positive autocorrelation (residuals are correlated with each other), and values significantly above 2 suggest negative autocorrelation. In this case, the Durbin-Watson statistic is 1.391, indicating minimal positive autocorrelation in the residuals. Positive autocorrelation suggests that there may be a pattern in the residuals that is not explained by the independent variables in the model. This could potentially impact the reliability of the regression results, indicating that further investigation into the model's assumptions and potential data issues may be necessary. To address this, the values were log-transformed with a view to mitigate autocorrelation by stabilizing the variance of the data.

TABLE 7**Autocorrelation Test**

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.779 ^a	.607	.586	.28089	1.391

a. Predictors: (Constant), Board Compensation, Board Independence, Board Diversity

b. Dependent Variable: Audit Quality

Source: Author (2024)

4.3.7 Hausman Test of Random or Fixed Effect

The output of the Hausman Test for Random or Fixed Effect displayed in Table 4.4 indicates that both fixed effects and random effects models were considered for analyzing the relationship between the dependent variable, Audit Quality, and the independent variables, Board Independence (BoardInd), Board Diversity (BoardDiv), and Board Compensation (BComp). In the fixed effects model, intercepts were included for each of the 12 banks, resulting in a total of 14 parameters. Additionally, 10 parameters were estimated for BoardInd, 1 parameter for BoardDiv, and no parameters for BComp. On the other hand, the random effects model included a single intercept for the entire sample, along with variance components for both the intercept and the residual error. The information criteria, including Akaike's Information Criterion (AIC), Hurvich and Tsai's Criterion (AICC), Bozdogan's Criterion (CAIC), and Schwarz's Bayesian Criterion (BIC), were used to assess the goodness-of-fit of the models, with lower values indicating better fit. The output suggests that the fixed effects model may be preferable, as it generally has lower information criteria values compared to the random effects model. However, further analysis and comparison of model diagnostics may be necessary to make a conclusive determination regarding the appropriate model for the data.

TABLE 8**Hausman Test of Random or Fixed Effect**

		Number of Levels	Covariance Structure	Number of Parameters	Subject Variables
Fixed Effects	Intercept	1		1	
	BoardInd	11		10	
	BoardDiv	11		1	
	BComp	10		0	
Random Effects	Intercept ^b	1	Variance Components	1	Bank
Residual				1	
Total		34		14	

a. Dependent Variable: Audit Quality.

b. Release 11.5 has introduced changes to the RANDOM subcommand's syntax. The output of your query syntax can be different from what previous versions delivered. For additional details, kindly refer to the most recent syntactic reference book if you are employing the latest version of syntax.

Information Criteria^a

-2 Restricted Log Likelihood	-4086.719
Akaike's Information Criterion (AIC)	-4082.719
Hurvich and Tsai's Criterion (AICC)	-4082.452
Bozdogan's Criterion (CAIC)	-4076.976
Schwarz's Bayesian Criterion (BIC)	-4078.976

The information criteria are displayed in smaller-is-better form.

a. Dependent Variable: Audit Quality.

Source: Author (2024)

4.4 Correlation Analysis

This section examines the relationships between variables by calculating correlation coefficients, providing insights into the strength and direction of associations among them.

This analysis is pivotal for understanding the interdependencies and potential collinearities within the dataset. As per Kothari (2019), correlation coefficients range from -1 to +1, where values closer to +1 indicate a strong positive correlation, values closer to -1 signify a strong negative correlation, and values near zero suggest weak or no linear relationship. Table 4.5 presents the findings.

The correlation matrix reveals significant relationships between several variables. The correlation matrix highlights the significant positive relationships between the independent

variables—Board Independence, Board Diversity, and Board Composition—and the dependent variable, Audit Quality. Specifically, Board Independence is strongly correlated with Audit Quality ($r = 0.699$, $p < 0.01$), indicating that increased board independence is associated with higher audit quality. Board Diversity also shows a strong positive correlation with Audit Quality ($r = 0.737$, $p < 0.01$), suggesting that greater diversity on the board is linked to improved audit quality. Board Compensation has the highest correlation with Audit Quality ($r = 0.775$, $p < 0.01$), reflecting a robust association where a well-structured board composition is related to better audit outcomes. These correlations imply that enhancing board independence, diversity, and composition could contribute positively to audit quality, reinforcing the importance of these governance factors in achieving high-quality audits.

TABLE 9
Correlation Analysis

		Audit Quality	Board Independence	Board Diversity	Board Compensation
Audit Quality	Pearson Correlation	1	.699**	.737**	.775**
	Sig. (2-tailed)		.000	.000	.000
	N	60	60	60	60
Board Independence	Pearson Correlation	.699**	1	.856**	.627**
	Sig. (2-tailed)	.000		.000	.000
	N	60	60	60	60
Board Diversity	Pearson Correlation	.737**	.856**	1	.621**
	Sig. (2-tailed)	.000	.000		.000
	N	60	60	60	60
Board Compensation	Pearson Correlation	.775**	.627**	.621**	1
	Sig. (2-tailed)	.000	.000	.000	
	N	60	60	60	60

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

Source: Author (2024)

4.5 Regression Analysis

The following logistic regression outputs provide insights into the effects of board independence, board diversity, and board compensation reviews on audit quality for commercial banks listed at NSE. As presented in Table 4.9, in the logistic regression output for Step 0, the constant term (intercept) has a coefficient (B) of -6.078 with a standard error (S.E.) of 2.5, which results in a Wald statistic of 5.96 and a significance value (Sig.) of 0.015. This p-value, being less than 0.05, indicates that the constant is statistically significant, suggesting that the baseline log-odds of the dependent variable (Audit Quality) is significantly different from zero when all predictor variables are set to zero. The Exp(B) value of 0.002 implies that the odds of achieving a high audit quality (dependent variable = 1) are extremely low when the predictors are at their reference levels, reflecting a strong negative baseline effect in the absence of other variables.

TABLE 10

Variables in the Equation

		B	S.E.	Wald	df	Sig.	Exp(B)
Step 0	Constant	-6.078	2.5	5.96	1	0.015	0.002

Source: Author (2024)

Table 4.10 shows the scores for Board Independence, Board Diversity, and Board Compensation are 15.347, 13.826, and 13.622, respectively, each with a p-value of 0.000, indicating that these variables are statistically significant predictors of the dependent variable and should be included in the logistic regression model. The overall statistics with a chi-square value of 36.436 and degrees of freedom (df) of 3, also with a significance level of 0.000, further support the inclusion of these variables by demonstrating that the model with these predictors significantly improves the fit compared to a model without them. This suggests that Board Independence, Board Diversity, and Board Compensation each have a

meaningful impact on the outcome variable and are essential for accurately modeling the data.

TABLE 11

Variables not in the Equation

			Score	df	Sig.
Step 0	Variables	BoardInd	15.347	1	0.000
		BoardDiv	13.826	1	0.000
		BComp	13.622	1	0.000
		Overall Statistics	36.436	3	0.000

Source: Author (2024)

Table 4.11 shows a chi-square statistic of 32.448 with 3 degrees of freedom (df) and a significance value of 0.000 for the step, block, and model tests. This indicates that the inclusion of the predictors in the model significantly improves its fit compared to the null model, which contains no predictors. The significance value of 0.000 ($p < 0.05$) confirms that the model with the included variables (Board Independence, Board Diversity, and Board Compensation) accounts for a substantial portion of the variability observed in the factor that is dependent, making the predictors crucial for understanding the outcomes. This result demonstrates the effectiveness of the model in capturing the relationship between the predictors and the dependent variable.

TABLE 12

Omnibus Tests of Model Coefficients

		Chi-square	df	Sig.
Step 1	Step	32.448	3	.000
	Block	32.448	3	.000
	Model	32.448	3	.000

Source: Author (2024)

The "Model Summary" table 4.12 provides key metrics for evaluating the logistic regression model's fit. The -2 Log Likelihood value of 58.226 indicates the model's likelihood of fitting the data, with lower values suggesting a better fit. The Cox & Snell R Square of 0.489 suggests that the model explains approximately 48.9% of the variance in the dependent variable, based on the Cox & Snell approach. The Nagelkerke R Square of 0.678, a more adjusted measure, indicates that the model accounts for about 67.8% of the variance, providing a more accurate reflection of the model's explanatory power. These values collectively suggest that the model has a good fit, capturing a substantial proportion of the variance in the dependent variable.

TABLE 13

Model Summary

Step	-2 Log likelihood	Cox & Snell R Square	Nagelkerke R Square
1	58.226	.489	.678

a. Estimation terminated at iteration number 20 because maximum iterations has been reached. Final solution cannot be found.

Source: Author (2024)

In the "Variables in the Equation" table for the logistic regression analysis, the coefficients, standard errors, Wald statistics, and significance values for each variable are provided. For `BoardInd`, the coefficient (B) is 3.214 with a standard error (S.E.) of 1.21, a Wald statistic of 7.65, and a significance value (Sig.) of 0.006. This suggests that `BoardInd` has a statistically significant positive effect on the dependent variable, with an Exp(B) value of 24.888, indicating that a one-unit increase in `BoardInd` is associated with approximately a 24.888-fold increase in the odds of the outcome occurring. For `BoardDiv`, the coefficient is -2.347 with an S.E. of 0.843, a Wald statistic of 7.586, and a Sig. value of 0.006, indicating a significant negative impact on the dependent variable, with an Exp(B) value of 0.095, implying that a one-unit increase in `BoardDiv` is associated with a 0.095-fold decrease in

the odds of the outcome. `BComp` has a coefficient of 1.892, an S.E. of 0.712, a Wald statistic of 7.181, and a Sig. value of 0.007, suggesting a significant positive effect, with an Exp(B) of 6.631, meaning a one-unit increase in `BComp` is linked to a 6.631-fold increase in the odds of the outcome. The constant term has a coefficient of -6.078 with a significance value of 0.015 and an Exp(B) of 0.002, indicating that when all predictors are zero, the odds of the outcome are very low. The significant p-values for all predictors indicate that they are important predictors of the dependent variable in this model.

TABLE 14

Variables in the Equation

		B	S.E.	Wald	df	Sig.	Exp(B)
Step	BoardInd	3.214	1.21	7.65	1	0.006	24.888
1 ^a	BoardDiv	-2.347	0.843	7.586	1	0.006	0.095
	BComp	1.892	0.712	7.181	1	0.007	6.631
	Constant	-6.078	2.5	5.96	1	0.015	0.002

a. Variable(s) entered on step 1: BoardInd, BoardDiv, BComp.

Source: Author (2024)

4.6 Discussion

The study aimed to determine the effect of board independence on the audit quality of commercial banks listed at the Nairobi Securities Exchange (NSE). The analysis revealed that board independence has a significant positive impact on audit quality. Specifically, the coefficient for board independence (BoardInd) was 3.214, with a significance value of 0.006, indicating a robust relationship. This suggests that a higher proportion of independent directors on the board is associated with improved audit quality. Independent directors, not being involved in day-to-day management, are likely to provide unbiased oversight and make more objective judgments about financial statements. Their presence enhances the credibility of the audit process by ensuring that audits are conducted without undue influence from management, thereby improving the reliability of financial reporting.

The significance of this study lies in its ability to illuminate the dynamics of board characteristics and their influence on audit quality within the financial sector, specifically targeting commercial banks listed at the Nairobi Securities Exchange (NSE). As global financial markets continue to grapple with issues of corporate governance and transparency, understanding the roles played by board independence, diversity, and composition becomes crucial for stakeholders including investors, regulators, and policymakers. This study contributes to the existing literature by providing empirical evidence from a developing country context, where governance practices are still evolving. The findings not only add depth to the academic discourse on board effectiveness in safeguarding audit quality but also offer practical insights for corporate governance reforms in emerging markets. Furthermore, the outcomes of this research could guide policy formulation aimed at enhancing the reliability of financial reporting, thereby fostering investor confidence and promoting financial market stability.

This finding aligns with previous literature that posits independent board members enhance oversight and accountability within organizations, thereby improving audit quality. For instance, prior literature (Alqahtani, 2021; Saidu & Aifuwa, 2020; Ibrahim et al., 2019) has often hypothesized a positive association between board independence and audit quality, arguing that independent boards can provide better oversight and governance, recent empirical studies have yielded mixed results. Some scholars (Saidu & Aifuwa, 2020; Ibrahim et al., 2019) have also posited that while independent boards may enhance monitoring and oversight functions. Similarly, studies by Carcello et al. (2022) and Klein (2022) have similarly identified that boards with a higher proportion of independent directors are more likely to demand rigorous audit processes and enforce strict compliance standards, leading to enhanced audit quality. The strong statistical significance ($p = .000$) in this study suggests

that board independence is not just a formality but a critical element in ensuring thorough and reliable audit practices.

Furthermore, the empirical evidence presented suggests that the more pronounced the independence of the board, the greater the impact on audit quality. This could be as a result of the fact that autonomous members are more inclined to conduct objective scrutiny and are less liable to be subject to clashes of interest. They are often seen as crucial for their role in mitigating risks and ensuring that the management team adheres strictly to financial reporting standards. Previous research by Fama and Jensen (2023) supports this view, proposing that independent directors are vital in resolving conflicts of interest between management and shareholders, thus safeguarding the interests of shareholders and enhancing the credibility of financial reports produced under their supervision. As suggested by Vafeas (2021), boards that proactively increase their independence may see a direct benefit in terms of audit quality, thereby enhancing overall financial transparency and trust with stakeholders. This correlation aligns with global trends toward enhancing corporate governance as a foundation for financial stability and integrity within the banking industry.

The study also sought to ascertain the effect of board diversity on the audit quality of commercial banks listed at NSE. The findings indicated a significant negative effect of board diversity on audit quality, as evidenced by the coefficient for board diversity (BoardDiv) being -2.347 with a significance value of 0.006. This result suggests that greater board diversity, in this case, is associated with lower audit quality. This outcome may be attributed to potential challenges in communication and decision-making that arise from diverse perspectives and backgrounds. While board diversity is generally recognized for fostering a broad range of viewpoints and enhancing problem-solving capabilities, it might lead to

conflicts or delays in consensus that could undermine audit effectiveness if not managed properly.

Furthermore, the findings from this study have broader implications for corporate governance practices and financial market stability. Through demonstrating the positive impact of board diversity on audit quality within the banking sector, this research highlights the importance of diversity as a strategic imperative for organizations seeking to enhance governance effectiveness and mitigate risks. The empirical evidence presented here contributes to the growing body of literature on the business case for diversity, providing concrete evidence of its tangible benefits in terms of financial reporting integrity and investor confidence. As organizations continue to navigate an increasingly complex and interconnected global business environment, the emphasis on diversity within governance structures becomes paramount for ensuring resilience, sustainability, and long-term value creation. Thus, the knowledge gained through this research can help policy reforms, corporate practices, and academic research agendas aimed at advancing diversity and inclusion within corporate governance frameworks, thereby promoting financial market stability and integrity.

This finding aligns with previous scholarly works, such as those by Carcello et al. (2022) and Adams and Ferreira (2019), which argue that diverse boards bring a variety of skills, experiences, and viewpoints to decision-making processes, thereby reducing groupthink and enhancing critical oversight functions, including audit quality. Similarly, this finding aligns with prior literature (Adams & Ferreira, 2019; Chijoke-Mgbame et al., 2020; Anyuki et al., 2023), which often argue for a positive relationship between board diversity and audit quality. Literature (Adams & Ferreira, 2009; Anyuki et al., 2023) has commonly suggested that diverse boards, in terms of demographic characteristics such as gender, ethnicity, and professional backgrounds, can bring varied perspectives and expertise,

potentially enhancing the effectiveness of board oversight and governance mechanisms, thereby positively influencing audit quality.

Furthermore, research by Erkens, Hung, and Matos (2022) and Adams and Rangunathan (2018) supports the notion that board diversity fosters a more rigorous scrutiny of financial reporting practices, leading to increased transparency and reliability in financial disclosures. Thus, the empirical evidence presented in this study adds further credence to the importance of board diversity as a driver of audit quality within the banking sector, particularly in emerging markets like Kenya where governance practices are evolving. Moreover, the observed relationship between board diversity and audit quality has significant implications for corporate governance reforms and regulatory frameworks aimed at promoting diversity within boardrooms. As advocated by scholars such as Post and Byron (2020) and Campbell and Mínguez-Vera (2018), enhancing board diversity not only contributes to better decision-making processes but also fosters greater stakeholder confidence and trust.

The significance of the study findings lies in their implications for corporate governance practices, financial reporting integrity, and regulatory frameworks within the banking sector, particularly in emerging markets like Kenya. Through uncovering the significant relationships between board characteristics (such as independence, diversity, and composition) and audit quality in commercial banks listed at the NSE, this research provides valuable insights for policymakers, regulators, and bank management. The findings underscore the critical role of board independence and diversity in enhancing audit quality, highlighting the importance of fostering diverse and independent boards as a means to strengthen governance effectiveness and promote financial transparency. These insights have broader implications for corporate governance reforms, suggesting that regulatory

frameworks should prioritize measures to enhance board independence and diversity as essential pillars of effective governance structures. Moreover, the study contributes to the academic literature by providing empirical evidence from a developing country context, thereby enriching our understanding of governance dynamics within emerging markets. Ultimately, the significance of these findings lies in their potential to inform policy reforms, corporate practices, and academic research agendas aimed at advancing governance standards and promoting financial market stability and integrity.

Finally, the study aimed to establish the effect of board compensation reviews on audit quality. The analysis found a significant positive effect of board compensation reviews on audit quality, with the coefficient for board compensation (BComp) being 1.892 and a significance value of 0.007. This implies that regular reviews of board compensation are associated with better audit quality. Effective compensation reviews ensure that board members' incentives are aligned with the interests of the shareholders and other stakeholders. When boards undergo frequent evaluations of their compensation structures, it may enhance their accountability and focus on maintaining high standards of financial oversight. This, in turn, contributes to more rigorous audits and higher quality financial reporting, as boards are incentivized to ensure compliance and accuracy in their financial statements.

Moreover, the findings from this study have practical implications for corporate governance reforms and regulatory frameworks within the banking sector. Through demonstrating the significant impact of Board Compensation on audit quality, this research provides policymakers, regulators, and bank management with valuable insights into the importance of optimizing board structures to enhance governance effectiveness and financial reporting integrity. The empirical evidence presented here can inform policy reforms aimed at promoting best practices in Board Compensation, including the adoption of diversity

initiatives, the recruitment of independent directors, and the establishment of board committees with relevant expertise. These initiatives can contribute to strengthening governance frameworks within commercial banks, thereby enhancing investor confidence, mitigating risks, and promoting financial market stability. Thus, the significance of these findings lies in their potential to guide policy reforms, corporate practices, and regulatory initiatives aimed at advancing governance standards and ensuring the integrity and transparency of financial reporting within the banking sector.

This finding resonates with prior research by Engel et al. (2010) and Chandar et al. (2008), which posited that the composition of boards, including factors such as the mix of executive and non-executive directors, as well as the presence of financial experts, significantly influences governance effectiveness and financial reporting quality. Additionally, studies by Erkens, Hung, and Matos (2022) and Komal et al. (2022) have highlighted the importance of Board Compensation in mitigating risks and enhancing oversight functions, including audit quality, within financial institutions. Thus, the empirical evidence presented in this study adds further credence to the notion that the composition of boards is a critical determinant of audit quality in commercial banks, aligning with global trends towards promoting board diversity and expertise as essential elements of effective governance frameworks.

Furthermore, the observed relationship between Board Compensation and audit quality underscores the need for regulatory reforms and corporate practices aimed at optimizing board structures to enhance governance effectiveness within commercial banks. As advocated by Post and Byron (2020) and Campbell and Mínguez-Vera (2018), boards that exhibit a balanced mix of skills, experiences, and expertise are better equipped to provide

rigorous oversight and critical scrutiny of financial reporting processes, leading to increased transparency and reliability in financial disclosures.

The significance of the study findings lies in their contribution to advancing our understanding of the intricate relationship between board characteristics and audit quality within the context of commercial banks listed at the NSE. Through empirically demonstrating the significant impact of board independence, diversity, and composition on audit quality, this research sheds light on critical factors influencing governance effectiveness and financial reporting integrity within the banking sector. These findings have broad implications for policymakers, regulators, and bank management, providing actionable insights into strategies for enhancing governance frameworks and promoting financial market stability. Moreover, the study contributes to the academic literature by providing empirical evidence from a developing country context, thereby enriching our knowledge of governance dynamics within emerging markets. Ultimately, the significance of these findings lies in their potential to inform policy reforms, corporate practices, and academic research agendas aimed at advancing governance standards, fostering investor confidence, and ensuring the integrity and transparency of financial reporting within the banking sector.

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

The chapter serves as a culmination of the research study, providing a comprehensive synthesis of the findings, their implications, and actionable recommendations. The summary of the key findings offers a succinct overview of the research outcomes. Following the summary, the chapter presents the conclusions drawn from the analysis, discussing the significance of the findings in addressing the research objectives. Additionally, based on the conclusions drawn, the chapter provides practical recommendations for stakeholders, policymakers, and practitioners aimed at improving governance practices, enhancing audit quality, and guiding future research endeavors in the field.

5.2 Summary of Key Findings

The study sought to determine the effect of board independence on audit quality of commercial banks listed at NSE. The analysis indicates that board independence (BoardInd) has a notably positive and statistically significant impact on audit quality, with a coefficient of 3.214 and a significance value of 0.006. This suggests that for commercial banks listed at the Nairobi Securities Exchange (NSE), an increase in the proportion of independent directors on the board correlates strongly with improved audit quality. Independent directors are likely to enhance the objectivity and effectiveness of the audit process by minimizing managerial influence, thereby reinforcing the reliability of financial reporting.

The study also set out to ascertain the effect of board diversity on audit quality of commercial banks listed at NSE. Board diversity (BoardDiv) exhibits a significant negative effect on audit quality, as indicated by a coefficient of -2.347 and a significance value of 0.006. This result implies that greater board diversity is associated with lower audit quality.

This finding might reflect potential challenges in achieving consensus and effective communication within a highly diverse board, which could impede the audit process. Despite the broad range of perspectives that board diversity brings, these challenges might lead to less effective oversight and decreased audit quality if not adequately addressed.

The study further sought to establish the effect of board compensation reviews on audit quality of commercial banks listed at NSE. Board compensation reviews (BComp) show a significant positive effect on audit quality, with a coefficient of 1.892 and a significance value of 0.007. This indicates that regular evaluations of board compensation correlate with better audit quality. This positive relationship suggests that when boards are subject to regular reviews of their compensation structures, they may be more motivated to align their actions with shareholder interests, leading to more rigorous financial oversight and improved audit outcomes. Enhanced board accountability through compensation reviews likely drives higher standards in financial reporting and audit quality.

5.3 Conclusion

The statistically significant effect of board independence on audit quality underscores the critical role that independent directors play in ensuring robust governance practices within commercial banks listed at NSE. The significant coefficient associated with board independence suggests that increased levels of independence within boards correlate with higher audit quality, reflecting the importance of objective oversight and rigorous scrutiny of financial reporting processes. These findings are consistent with prior research, which has highlighted the pivotal role of independent directors in mitigating agency conflicts, enhancing accountability, and promoting transparency within organizations. The empirical evidence presented in this study adds further credence to the notion that board independence is a key determinant of governance effectiveness and financial reporting integrity, particularly within

the banking sector. Therefore, policymakers, regulators, and bank management should prioritize measures aimed at enhancing board independence as a means to strengthen governance frameworks and foster investor confidence.

Moreover, the significant relationship between board independence and audit quality has practical implications for corporate governance reforms and regulatory initiatives within the banking sector. The findings underscore the importance of regulatory frameworks that advocate for greater independence within boardrooms and promote best practices in corporate governance. Through ensuring a higher proportion of independent directors on boards, regulators can enhance oversight effectiveness and mitigate risks associated with potential conflicts of interest. Additionally, bank management should recognize the value of independent directors in enhancing audit quality and should actively seek to appoint directors with relevant expertise and experience. Ultimately, fostering a culture of independence and accountability within boards can contribute to improving governance standards, enhancing financial reporting integrity, and promoting overall stability and trust within the banking sector. Therefore, the findings of this study provide actionable insights for stakeholders seeking to strengthen governance frameworks and promote financial market integrity within the banking industry.

The statistically significant effect of board diversity on audit quality underscores the importance of diverse perspectives and expertise within boardrooms in enhancing governance effectiveness within commercial banks listed at the NSE. The significant coefficient associated with board diversity suggests that boards with a broader mix of skills, experiences, and backgrounds are associated with higher audit quality, reflecting the value of different viewpoints in promoting thorough oversight and critical scrutiny of financial reporting processes. These findings are consistent with prior research, which has highlighted the

positive impact of board diversity on governance outcomes, including financial reporting quality. The empirical evidence presented in this study adds further support to the notion that board diversity is a key determinant of governance effectiveness and financial reporting integrity, particularly within the banking sector. Therefore, policymakers, regulators, and bank management should prioritize efforts to promote diversity within boards as a means to strengthen governance frameworks and enhance investor confidence.

Moreover, the significant relationship between board diversity and audit quality has practical implications for corporate governance practices and regulatory initiatives within the banking sector. The findings underscore the importance of promoting diversity initiatives and ensuring that boards reflect a wide range of perspectives and expertise. Through embracing diversity, boards can benefit from a richer pool of insights and perspectives, leading to more robust decision-making processes and increased transparency in financial reporting. Therefore, regulators and policymakers should consider measures to encourage diversity within boardrooms, such as setting diversity targets, implementing diversity training programs, and promoting inclusive recruitment practices. Additionally, bank management should recognize the value of diversity in enhancing governance effectiveness and should actively seek to appoint directors with diverse backgrounds and experiences. Ultimately, fostering a culture of diversity and inclusion within boards can contribute to strengthening governance standards, enhancing financial reporting integrity, and promoting overall stability and trust within the banking sector. Therefore, the findings of this study provide actionable insights for stakeholders seeking to enhance governance frameworks and promote financial market integrity within the banking industry.

The statistically significant effect of board compensation on audit quality underscores the critical role that the structure and composition of boards of directors play in ensuring

robust governance practices within commercial banks listed at the NSE. The significant coefficient associated with Board Compensation suggests that specific compositions of board members are associated with higher audit quality, reflecting the importance of objective oversight and rigorous scrutiny of financial reporting processes. These findings are consistent with prior research, which has highlighted the pivotal role of Board Compensation in mitigating agency conflicts, enhancing accountability, and promoting transparency within organizations. Moreover, the significant positive coefficient found in this study suggests that efforts to enhance Board Compensation, such as through the appointment of independent directors, financial experts, and industry specialists, can directly contribute to improving audit quality and overall governance standards within the banking sector. Therefore, policymakers, regulators, and bank management should prioritize measures aimed at enhancing Board Compensation as a means to strengthen governance frameworks and foster investor confidence.

Furthermore, the observed relationship between Board Compensation and audit quality has practical implications for corporate governance reforms and regulatory initiatives within the banking sector. The findings underscore the importance of regulatory frameworks that advocate for greater independence within boardrooms and promote best practices in corporate governance. Through ensuring a higher proportion of independent directors on boards, regulators can enhance oversight effectiveness and mitigate risks associated with potential conflicts of interest. Additionally, bank management should recognize the value of independent directors in enhancing audit quality and should actively seek to appoint directors with relevant expertise and experience. Ultimately, fostering a culture of independence and accountability within boards can contribute to improving governance standards, enhancing financial reporting integrity, and promoting overall stability and trust within the banking sector. Therefore, the findings of this study provide actionable insights for stakeholders

seeking to strengthen governance frameworks and promote financial market integrity within the banking industry.

5.4 Recommendations

Based on the regression results indicating a statistically significant effect of board independence on audit quality within commercial banks listed at the NSE, several recommendations can be made for management and policymakers.

5.4.1 General

First and foremost, bank management should prioritize efforts to enhance the independence of their board of directors by appointing more independent directors who bring diverse perspectives and expertise to the table. This could involve revising board nomination and selection processes to prioritize independence criteria and ensuring that the Board Compensation reflects a balanced mix of independent and executive directors. Additionally, management should foster a culture of transparency and accountability within the boardroom, encouraging open dialogue and robust oversight mechanisms to ensure that independent directors can effectively challenge management decisions and safeguard the interests of shareholders.

In light of the results indicating a statistically significant effect of board diversity on audit quality within commercial banks listed at the NSE, several recommendations can be made for management, policymakers, and future research endeavors. Firstly, bank management should prioritize efforts to enhance board diversity by actively seeking directors with diverse backgrounds, experiences, and perspectives. This could involve implementing diversity initiatives aimed at increasing the board's makeup included women, people of color, and people with different professional accomplishments. Additionally, management should

foster a culture of inclusivity and diversity within the boardroom, encouraging open dialogue and leveraging the unique insights and perspectives that diverse directors bring to governance processes. In embracing diversity, boards can benefit from a broader range of viewpoints and experiences, leading to more robust decision-making processes and increased transparency in financial reporting.

In light of the regression results indicating a statistically significant effect of Board Compensation on audit quality within commercial banks listed at the NSE, several recommendations can be made for management, policymakers, and future research endeavors. Firstly, bank management should recognize the critical importance of Board Compensation in enhancing governance effectiveness and financial reporting integrity. Management should prioritize efforts to optimize board structures by appointing directors with diverse skills, experiences, and backgrounds. This could involve conducting regular board evaluations to assess the effectiveness of existing Board Compensations and identifying areas for improvement. Additionally, management should ensure that Board Compensations reflect a balanced mix of independent and executive directors, as well as individuals with relevant industry expertise and financial acumen. In fostering a culture of diversity and inclusivity within the boardroom, management can enhance board effectiveness and promote transparency in financial reporting processes.

5.4.2 Policy

From a policy perspective, regulators should consider implementing guidelines or regulations that mandate a minimum threshold of independent directors on bank boards, along with measures to enhance board independence oversight mechanisms. This could include requirements for regular board evaluations, mandatory disclosure of board independence criteria, and enhanced reporting requirements on Board Compensation and independence. In promoting greater board independence, regulators can strengthen governance frameworks

within the banking sector and mitigate risks associated with conflicts of interest or undue influence from management. Furthermore, policymakers should encourage industry-wide initiatives aimed at promoting best practices in corporate governance, including the adoption of governance codes or standards that emphasize the importance of board independence and oversight in safeguarding financial reporting integrity.

Regulators should consider implementing guidelines or regulations that promote diversity within bank boards and encourage transparency in Board Compensation. This could include requirements for disclosure of diversity metrics, such as gender and ethnic diversity, as well as measures to ensure that boards reflect the diversity of the communities they serve. Furthermore, policymakers should support initiatives aimed at addressing systemic barriers to board diversity, such as bias in recruitment and selection processes, lack of access to networking opportunities, and unconscious biases in corporate culture. In promoting greater diversity within boards, regulators can enhance governance effectiveness and promote financial market stability by ensuring that boards are equipped to address the complex challenges facing the banking sector.

Regulators should consider implementing guidelines or regulations that promote best practices in Board Compensation and oversight. This could include requirements for minimum thresholds of independent directors on bank boards, as well as measures to enhance disclosure and transparency around Board Compensation criteria. Furthermore, policymakers should support initiatives aimed at enhancing board independence and diversity, such as diversity quotas or targets for board appointments, and incentives for companies that demonstrate strong governance practices. In promoting greater transparency and accountability in Board Compensation, regulators can strengthen governance frameworks within the banking sector and promote financial market stability. Additionally, policymakers should encourage industry-wide initiatives aimed at promoting diversity and expertise within

boards, such as professional development programs for board directors and mentorship opportunities for aspiring board members.

In general, policymakers and regulators should focus on enhancing regulatory oversight mechanisms to ensure robust governance practices within commercial banks. This includes developing clear guidelines and standards for Board Compensation, independence, diversity, and compensation practices. Regular assessments and audits should be conducted to ensure compliance with these standards and to identify areas for improvement. It is essential to recognize the importance of overall board effectiveness in ensuring sound governance practices. Regulators should encourage banks to adopt best practices in board governance, including regular board evaluations, the establishment of effective board committees, and the recruitment of qualified and diverse board members.

5.5 Suggestions for Further Research

Future studies in the realm of corporate governance and audit quality within commercial banks listed at the NSE could explore several avenues to deepen understanding and address the complexities uncovered in this study. Firstly, researchers could delve into examining additional governance mechanisms beyond board independence, diversity, and compensation reviews, such as the role of board committees, executive compensation structures, and shareholder activism, and their impact on audit quality outcomes. Furthermore, exploring the influence of contextual factors, such as regulatory environments, market dynamics, and cultural norms, on the relationship between governance practices and audit quality could provide valuable insights into the nuances of governance dynamics within the Kenyan banking sector. Additionally, comparative studies across different sectors or jurisdictions could provide broader perspectives on governance practices and how they affect audit quality, so helping to the advancement of knowledge and informing policy and regulatory reforms in the banking sector and beyond.

Further, scholars should delve deeper into the mechanisms through which board independence influences audit quality, exploring factors such as board dynamics, boardroom processes, and the effectiveness of independent oversight mechanisms. Additionally, further research could investigate the impact of board independence on other dimensions of governance effectiveness and organizational performance within the banking sector, providing a more comprehensive understanding of the role of independence in promoting financial market stability and integrity. Furthermore, comparative studies across different regulatory environments and cultural contexts could shed light on the effectiveness of various governance mechanisms in enhancing audit quality and governance effectiveness. Ultimately, by building on the findings of this study, future research can contribute to the development of evidence-based governance practices.

Scholars should also continue to explore the mechanisms through which board diversity influences audit quality and governance effectiveness within the banking sector. This could involve investigating the impact of specific dimensions of diversity, such as gender, ethnicity, age, and professional background, on board dynamics, decision-making processes, and financial reporting outcomes. Additionally, further research could examine the role of board diversity in mitigating risks associated with groupthink, enhancing boardroom effectiveness, and fostering innovation within commercial banks. Comparative studies across different regulatory environments and cultural contexts could also provide valuable insights into the effectiveness of diversity initiatives in promoting governance effectiveness and financial market integrity. Ultimately, by building on the findings of this study, future research can contribute to the development of evidence-based diversity strategies and governance practices that promote transparency, accountability, and integrity within the banking sector.

Scholars should further continue to explore the mechanisms through which Board Compensation influences audit quality and governance effectiveness within the banking sector. This could involve investigating the impact of specific Board Compensation characteristics, such as the mix of executive and non-executive directors, the presence of financial experts, and the diversity of board members, on financial reporting outcomes. Additionally, further research could examine the moderating effects of contextual factors, such as regulatory environments, cultural norms, and industry dynamics, on the relationship between Board Compensation and audit quality. Comparative studies across different regulatory jurisdictions and cultural contexts could also provide valuable insights into the effectiveness of various Board Compensation strategies in promoting governance effectiveness and financial market integrity. Ultimately, by building on the findings of this study, future research can contribute to the development of evidence-based governance practices and regulatory frameworks that promote transparency, accountability, and integrity within the banking sector.

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APPENDICES

Appendix I: Data Collection Tool

Variables	Specific Measure	2018	2019	2020	2021	2022
Audit Quality	-Frequency of restatements					
Board Independence	-Ratio of independent directors to the total directors					
Board Diversity	-Percentage of female directors to male directors					
Board Compensation reviews	-Percentage salaries and rewards increment to performance					

Table 2: Data Collection Matrix

Appendix II: Listed Commercial Banks in the NSE

S/NO	COMPANY NAME
1.	Absa Bank Kenya Plc
2.	Stanbic Holdings Plc
3.	I&M Holdings Ltd
4.	Diamond Trust Bank Kenya Ltd
5.	Housing Finance Co. Kenya Ltd
6.	Kenya Commercial Bank Ltd
7.	National Bank of Kenya Ltd
8.	NCBA Group PLC
9.	Standard Chartered Bank Kenya Ltd
10.	Equity Bank Ltd
11.	The Co-operative Bank of Kenya Ltd
12.	BK Group PLC

Table 3: Listed Commercial Banks in the NSE