

**BOARD CHARACTERISTICS AND MODIFIED AUDIT OPINION OF  
COMPANIES LISTED AT THE NAIROBI SECURITY EXCHANGE**

**BY**

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**MASTER OF SCIENCE IN COMMERCE (FINANCE & ACCOUNTING)**

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OF MASTER OF SCIENCE IN COMMERCE (FINANCE & ACCOUNTING) IN THE  
SCHOOL OF BUSINESS AT KCA UNIVERSITY**

**DECEMBER, 2025**

**DECLARATION**

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

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## ABSTRACT

Board characteristics are essential in determining the modified audit opinion of listed companies at the Nairobi Securities Exchange. However, there has been a deterioration of quality in financial reporting, with up to 64.7% of companies receiving qualified report, while just 32% have been able to receive clean reports. This research aimed to identify the effect of board characteristics on the modified audit opinion of the companies listed at Nairobi Security Exchange. The specific objectives were: to establish the effect of board size on modified audit opinion, to analyse the effect of frequency of board meetings on modified audit opinion, to determine how board independence affects modified audit opinion and to establish the effect of board professional qualification on modified audit opinion of companies listed at the Nairobi Securities Exchange. The study was premised on agency, stakeholders, institutional, and stewardship theories. The researcher used a descriptive research design with a population of 46 listed companies, where all were included in the study. The study used panel data obtained from annual financial reports between 2015 and 2024 from all the listed Companies at the Nairobi Securities Exchange. Panel data analysis was done using the R software. The findings showed that board professional qualification had an insignificant negative effect on the modified audit opinion. Board independence demonstrated a negative significant effect on modified audit opinion. The results showed that board size had a positive significant effect on modified audit opinion. It was discovered that board frequency of meetings negatively affects modified audit opinion. The conclusion made was board professional qualification, independent board and frequency of board meetings are critical in reducing modified audit opinion of companies at the Nairobi Securities exchange. It was recommended that companies should adopt an optimum board size for efficiency in decision making. Future study may narrow down to a particular sector and incorporate moderating variables.

**KEY WORDS:** Board Size, Board Independence, Board Meetings, Board Professional Qualification, Modified Audit Opinion, Nairobi Securities Exchange.

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## TABLE OF CONTENTS

<b>ABSTRACT</b> .....	<b>iii</b>
<b>ACKNOWLEDGEMENT</b> .....	<b>iv</b>
<b>TABLE OF CONTENTS</b> .....	<b>v</b>
<b>LIST OF TABLES</b> .....	<b>vii</b>
<b>LIST OF FIGURES</b> .....	<b>viii</b>
<b>ACRONYMS AND ABBREVIATION</b> .....	<b>ix</b>
<b>OPERATION DEFINITION OF TERMS</b> .....	<b>x</b>
<b>CHAPTER ONE:INTRODUCTION</b> .....	<b>1</b>
1.1 Background of the Study .....	1
1.1.1 Board Characteristics .....	3
1.1.2 Modified Audit Opinion .....	6
1.1.3 Board Characteristics and Modified Audit Opinion .....	7
1.1.4 Listed Companies at Nairobi Security Exchange .....	8
1.2 Statement of the Problem.....	9
1.3 Research Objectives.....	11
1.3.1 General Objective .....	11
1.3.2 Specific Objectives .....	11
1.4 Research Questions .....	11
1.5 Significance of the Study .....	12
1.5.1 Practical Contributions for Managers .....	12
1.5.2 Contribution to the Policy .....	12
1.5.3 Contribution to the Theory.....	13
1.5.4 Contribution to Scholars and Researchers .....	13
1.6 The Scope of The Study.....	13
<b>CHAPTER TWO:LITERATURE REVIEW</b> .....	<b>15</b>
2.1 Introduction.....	15
2.2 Theoretical review .....	15
2.2.1. Agency Theory.....	15
2.2.1 Stewardship Theory .....	17
2.2.3 Stakeholders Theory .....	18
2.2.4 Institutional Perspective Theory .....	19
2.3 Empirical Review.....	20
2.3.1 Board Professional Qualification and Modified Audit Opinion .....	20
2.3.2 Board Size and Modified Audit Opinion .....	23
2.3.3 Board Meetings and Modified Audit Opinion .....	26

2.3.4 Board Independence and Modified Audit Opinion.....	28
2.4 Summary of the Research Gaps .....	30
2.5 Conceptual Framework.....	32
2.6 Operationalization Study of Variables.....	34
<b>CHAPTER THREE:RESEARCH METHODOLOGY .....</b>	<b>36</b>
3.1 Introduction.....	36
3.2 Research Design.....	36
3.3 Target Population.....	36
3.4 Sampling and Sampling Technique .....	37
3.5 Data Collection, Processing and Analysis .....	37
3.6 Diagnostic Test .....	38
<b>CHAPTER FOUR:DATA ANALYSIS, INTERPRETATION AND DISCUSSION .....</b>	<b>39</b>
4.1. Introduction.....	39
4.2 Response Rate.....	39
4.3 Descriptive Statistics.....	40
4.4. Diagnostic Tests.....	44
4.4.1 Normality Test .....	44
4.4.2. Multicollinearity Test.....	46
4.5. Panel Data Analysis .....	50
<b>CHAPTER FIVE:SUMMARY, CONCLUSION AND RECOMMENDATION .....</b>	<b>58</b>
5.1. Introduction.....	58
5.2. Summary of Findings.....	58
5.2.1 Board Professional Qualification and Modified Audit Opinion of Listed Companies.....	59
5.2.2. Board Independence and Modified Audit Opinion of Listed Companies .....	59
5.2.3. Board Size and Modified Audit Opinion of Listed Companies.....	60
5.2.4. Board Frequency of Meeting and Modified Audit Opinion of Listed Companies	61
5.3. Conclusion .....	61
5.4. Recommendation .....	62
5.4.1. Theoretical Recommendations.....	62
5.3.2. Policy Recommendations.....	63
5.3.4. Practical Recommendations.....	63
5.4.4 Recommendation for Further Studies .....	64
<b>REFERENCES.....</b>	<b>66</b>
APPENDIX I: DATA COLLECTION SHEET.....	88
<b>APPENDIX II: LISTED COMPANIES AT NAIROBI SECURITIES EXCHANGE....</b>	<b>89</b>
<b>APPENDIX III: DATA SNAPSHOT .....</b>	<b>91</b>

## LIST OF TABLES

Table 2.1. Summary of Research Gaps.....	43
Table 2. 2. Operationalization1 of variables.....	45
Tble 3.1. A List of Diagnostic Procedures.....	49
Table 4.1. Response Rate.....	51
Table 4.2. Descriptive Summary Statistics.....	52
Table 4.3. Shapiro Wilk Test.....	56
Table 4.4. Multicollinearity Detection.....	57
Tabl 4.5. Heteroskedasticity Test.....	58
Table 4.6. Autocorrelation Test.....	59
Table 4.7. Hausman Test.....	60
Table 4.8. Fixed Effect Model.....	62
Table 4.9. Random Effect Model.....	66

## LIST OF FIGURES

Figure 2.1: Conceptual Framework.....	44
Figure 4.1: Q-Q Normality Test.....	56

## ACRONYMS AND ABBREVIATION

<b>BOD:</b>	Board of Directors
<b>BS:</b>	Board Characteristics
<b>CMA:</b>	Capital Market Authority
<b>MAO:</b>	Modified Audit Opinions
<b>NSE:</b>	Nairobi Security Exchange
<b>ISA:</b>	International Standards of Auditing
<b>ICPAK:</b>	Institute of Certified Public Accountants of Kenya
<b>VIF:</b>	Variance Inflation Factor

## OPERATION DEFINITION OF TERMS

- Modified audit opinion:** In this study, audit opinions are defined as the formal conclusions issued by auditors regarding whether financial statements are presented fairly and in accordance with the applicable accounting framework. These opinions are operationalized by categorizing them into types such as unqualified, qualified, adverse, and disclaimer opinions, based on the presence and significance of material misstatements identified during the audit process (Alkelani, Hussin, & Salim, 2020)
- Board professional qualification:** This study defines board professional qualification as the level of experience, skills, knowledge, and independence that board members possess in relation to the firm and its operations. It is measured by looking at their academic qualifications, professional training, work experience, and ability to make independent decisions. (Gaur, Bathula, & Singh, 2015)
- Board independence:** In this study, an independent board member is defined as a director who does not engage in the firm's daily operations and has no material financial, familial, or professional relationship with the company. Independence is operationalized by evaluating the absence of executive roles, business ties, or other affiliations that could impair objective oversight. (Al-Saidi, 2020)
- Board meetings:** In this study, a board meeting is defined as a scheduled and formal gathering of the company's board of directors, occasionally including invited stakeholders, to deliberate on key strategic issues, assess company performance, and execute the board's legal and governance duties. The concept is operationalized by examining the number of meetings held annually,

member attendance, and the scope of topics discussed. (Alkelani et al., 2020).

**Board size:**

This includes the number of board members in each accounting year which includes the non-executive directors, the executive and outside directors (Karkowska & Acedański, 2020).

**Board Characteristics:**

For the purpose of this research, the board of directors refers to a group of individuals appointed or elected to collectively oversee and guide the strategic and operational activities of an organization, whether for-profit or non-profit. The term is operationalized by analyzing the board's structure, responsibilities, and governance roles as defined in official organizational documents (Kılıç & Kuzey, 2020).

# CHAPTER ONE

## INTRODUCTION

### 1.1 Background of the Study

Auditing is a crucial financial accounting procedure that can be used to support organizational goals and objectives. After an audit has been done in an organization, a report is generated by the auditors to support strategic decision-making processes (Omer *et al.*, 2020). This report however, may have effect on decision making based on the quality of financial reporting. There are different types of opinions issued by an auditor including the Modified Audit Opinion. The Modified Audit Opinion is particularly significant because it indicates issues such as material misstatements, limitations in audit scope, or uncertainties about an entity's going concern status (International Auditing and Assurance Standards Board [IAASB], 2020).The connection between board characteristics and modified audit opinion has been reported in different literature especially with a focus on how the composition and functioning of the board of directors in a company have the capacity to influence the likelihood that a company will receive a modified audit opinion from external auditors (Oruke *et al.*, 2020). Other researchers however, argue that board characteristics does not have any influence on modified audit opinion (Alkelani *et al.*, 2020).

In every company, an audit opinion is essential as it indicates efficiency of the management (Tian & Xin, 2017). An analysis of companies' audit quality worldwide reveals rising upsurge in the quality of audit opinion evidenced in corporate bankruptcies with up to 10% of fraud cases experienced in the corporate world due to low audit quality (Gilles *et al.*, 2021). In Macedonian Stock Exchange (2014-2018), there is a worrying trend in the audit modification which has increased from 54.1% (2014) to 59.1% (2018) with 20% drop in clean reports (Srbinska, 2022).

A similar experience is replicated in the Republic of Serbia where listed companies engage in profit manipulation to cause false impression of company performance. Dordevic and Spasic (2022) add that from the 64 companies studied in Serbia, 22 were engaged in modified audit opinion thereby lowering quality in audit report.

Within the Asian continent, listed companies in Indonesia received unqualified audit before closure of operations (Averio, 2020), a trend that is witnessed in Malaysia where listed companies continue to receive modified audit opinion which lowers financial reporting (Omer et al., 2020). In Cameroon, board of directors have been accused of producing poor quality financial statements to manipulate accounts and mislead stakeholders. Djousta et al. (2015) add that upto 79% of financial documents presented by the board have not complied to accounting principles while Foka et al. (2018) note how 60.7% of Cameroonian listed companies made adjustments in their financial statements hence there is rarely reliable financial documents in Cameroonian business environment (Gilles et al., 2021).

In the Kenyan context, the reliability of financial reports issued by companies listed on the Nairobi Securities Exchange (NSE) has come under scrutiny. The NSE serves as Kenya's primary capital market, allowing firms to raise funds through equity and debt instruments while adhering to stringent reporting and governance standards. Despite regulatory efforts, a growing number of companies continue to receive MAOs. A study by Oruke et al. (2022) revealed that 64.7% of companies received qualified audit opinions, 0.7% received adverse opinions, and 2.5% had disclaimer audits. Only 32% received unqualified (clean) audit opinions, pointing to persistent challenges in financial transparency.

Regulatory bodies such as the Capital Markets Authority (CMA) and the Institute of Certified Public Accountants of Kenya (ICPAK) have repeatedly raised concerns about delayed disclosures, non-compliance with International Financial Reporting Standards (IFRS), and poor audit quality among listed firms (CMA, 2023; ICPAK, 2022). These trends raise critical questions about the effectiveness of corporate boards in overseeing the financial reporting process, particularly in light of increasing expectations for board accountability and independence.

### **1.1.1 Board Characteristics**

Board characteristics is important in agency problems and decreasing overall likelihood for receiving a modified audit opinion. The main function of the board is to ensure that the goals of an organization are being met (Ibrahim & Jehu, 2018). Board characteristics is focused in controlling financial reports' quality and hence transparency to safeguard the interests of investors and the general public (Saaydah, 2019). Additionally, Kimani (2017) states that the directors of the board have the duty of ensuring that the interest of the shareholders is safeguarded and the statement signed are true.

According to Capital Markets Authority (CMA) (2016), board characteristics is conceptualized into sufficient board size, three or more independent non-executive board participants and one or more board member who holds a professional qualification in audit or accounting. Board characteristics components have been highlighted by Khan et al. (2021) as board independence, board gender diversity, board size and CEO duality. Zia ur Rehman (2020) recognize board characteristics in the form of; independent directors, outside directors, board size, CEO duality, composition of the board, nationality, race, member ownership and panel members' educational level. Zhu et al. (2024) have also noted how board characteristic is important in

enhancing social and environmental governance through CEO duality, gender diversity, board size, foreign board, managerial ownership and board meetings.

This study measured board characteristics through; professional quality of the board, independent board, frequency of board meetings and board size. CMA (2016) recognized how board size, professionalism and independence were crucial in improving quality audit thus the selection of the variables. Khan *et al.* (2021) preferred board education level while Zhu *et al.* (2024) attributed quality reporting from frequency of board meetings thus the choice of the variables in determining their effect in modified audit opinion of listed companies in Nairobi Securities Exchange.

It is crucial that the members of the board characteristics possess these auditing and accounting qualifications to enable impartial assessment of the different emergent concerns and to guarantee efficient oversight by the board characteristics (Alkilani, Saleh, Nordin, Wan, & Salim, 2020) The Capital Markets Authority (2016) released regulations mandating that listed firms' audit committees include a minimum of one member with a professional certificate in accounting or audit. Alkelani *et al.* (2020) says that the primary goal of financial knowledge is to increase the board characteristics' efficacy in overseeing the financial reports. As a result, having financial experience on the board is essential for improving financial reporting and for managing the finance and audit departments.

Board independence is cited by several empirical literatures as one of the key features of board characteristics (Al-Saidi, 2020; Alkelani, Hussin, & Salim, 2020; Adebisi, 2017) as it generally boosts its efficacy in performing its duties, which include quality control over the auditing process and an open and impartial nomination and remuneration policy (Almaqtari *et al.*, 2021). Adebisi (2017) contends that an independent board may more successfully oversee CEO

conduct, thereby enhancing the quality of financial reporting and generating value for shareholders.

The frequency of board meeting is critical in realizing an organization's strategic objectives. Board meetings demonstrate the commitment of the board in discharging their mandate (Pandey et al., 2022). Additionally, regular board meetings may enhance deliberation of problems organization is facing such as risk reduction and monitoring to improve quality reporting. The frequency of board meetings may also help an organization to adapt to market changes and lower risk exposure (Lee et al., 2021). Globally the board is expected to hold a minimum schedule of meetings each financial year (Umar et al., 2024).

Board size is very crucial in the board's functioning. The capacity to supervise corporate governance is impacted by board size hence a smaller board will perform governance and oversight-related tasks more successfully than a larger board. (Huu Nguyen, 2020). Obigbemi et al. (2016) posit that board size is crucial as it influence quality audit reports by giving room for manipulation to realize objectives (Shahwan & Almubaydeen, 2020).

The size of the board is a crucial factor in determining the extent to which a firm will receive a modified audit opinion. Saaydah (2019) shows how the size of the board of directors has a significant positive predictor in receiving a modified audit opinion. More specifically, a larger board size means there are chances that many of the board of directors will be independent directors able to streamline financial processes within the organization.

### **1.1.2 Modified Audit Opinion**

The necessity for the quality of financial reporting has gained attention from many investors, scholars, and regulatory players (Rotich, 2017). The quality of financial report however, may be achieved through a reasonable audit opinion which is free from biasness with honest disclosure of information (Budman, 2021). Audit opinion is important in providing communication to the users of financial information and therefore, must offer explanation and fairness and whether the report conforms to the accepted standards of accounting principles. Audit opinion is arrived at after the process goes through different stages in the audit process as prescribed by the required standards upon which the auditor gives opinion based on substantive evidence (Chen *et al.*, 2017).

Modified audit opinion is a signal of business failure that will occur due to bankruptcy. Zdolsek *et al.* (2022) add that firms with modified audit opinion have poor financial structures with worse liquidity and profitability where the audit process take long. Modified audit opinion has been used by some scholars as an independent variable, for instance (Liu, Cullian, & Zhang, 2018). Other scholars continue to use modified audit opinion as a dependent variable (Omer *et al.*, 2020; Saaydah, 2020).

Despite many studies on modified audit opinion, the challenge still remains on what factors affect the issue of modified audit opinions. It has been identified that the main issue affecting modified audit opinion is board, however some researchers agree that some characteristics affect the likelihood of modified audit opinion while others disagree giving conflicting results (Alkelani *et al.*, 2020 ;Saaydah, 2020). This results to the question on what exactly affect the publication of a modified audit opinion. Based on the agency theory, the activity of the board should impact the financial reporting quality. The study therefore aimed to address the question, the impact of board

characteristics (size of the board, board independence, board professional qualification and board meetings) on modified audit opinion on companies listed at NSE.

### **1.1.3 Board Characteristics and Modified Audit Opinion**

Board characteristics refer to the intrinsic structure of communication and power at the boards phase of a business (Mandala, 2018). According to the agency theory, the board is the main solution for the agency conflict and one of the major important aspects in monitoring. It is key in decision making in aspects which might have been excluded between owners and managers in initial contacts. It's therefore the need for research to establish how board characteristics affect modified audit opinion which has created attention to most researchers. The arguments are however not conclusive.

Globally the findings have been of mixed whether some board characteristics affect modified audit opinion such as, in Malaysia where Ishak and Md Yusof (2015) consider independence of the board and modified audit opinion where combined board characteristics has an effect on the issue of modified audit opinion. Locally, Oruke et al. (2020) showed that board independence and size have a negative, significant impact on the modified audit opinion while Mandala (2018) observes the unfavorable correlation between the board independence and the modified audit opinion. Rotich (2017) appreciates how board size has an impact on financial reporting.

#### **1.1.4 Listed Companies at Nairobi Security Exchange**

The Nairobi Securities Exchange (NSE) is a cornerstone of Kenya's financial system, facilitating capital formation, investment, and economic growth. As of 2025, the NSE hosts 63 listed companies across diverse sectors, including real estate investment trusts, exchange-traded funds, and derivatives (CMA, 2021). These firms operate under the regulatory oversight of the Capital Markets Authority (CMA), which has issued guidelines to promote sound corporate governance and financial transparency.

Recent market data underscores the NSE's growing significance. As of August 2025, the NSE's market capitalization stands at approximately KES 2.54 trillion, reflecting increased investor activity and market recovery. On July 9, 2025, the exchange recorded 13.4 million shares traded across 2,667 deals, with a total market value of KES 274.7 million. In 2024, the NSE achieved its highest single-day turnover of KES 3 billion, and the bond market turnover reached a record KES 1.5 trillion, marking a 140% increase year-on-year. These figures highlight the NSE's expanding role in Kenya's capital markets and the urgency of ensuring financial reporting quality.

Despite regulatory efforts, concerns persist regarding the reliability of financial statements among NSE-listed firms. A key indicator of poor reporting quality is the issuance of Modified Audit Opinions (MAOs), which signal that a company's financial statements may not fully comply with accounting standards. MAOs can erode investor confidence, reduce market credibility, and reflect underlying governance weaknesses.

To address these challenges, the CMA's 2002 corporate governance guidelines emphasized the importance of board structure in enhancing accountability. Specifically, the guidelines recommend that boards: Include a majority of independent, non-executive directors, Maintain an optimal size to ensure effective decision-making and Consist of members with appropriate qualifications and expertise. These board characteristics are believed to influence the effectiveness of internal controls and the integrity of financial reporting. However, empirical evidence on the relationship between board composition and audit outcomes particularly MAOs remains limited in the Kenyan context. CMA's 2018 report revealed that 44% of listed companies failed to meet transparency standards, while another 17 firms were flagged for poor governance practices (CMA, 2018). High-profile corporate failures such as Mumias Sugar, Kenya Airways, and Uchumi Stores have further raised concerns about board oversight and investor protection, resulting in losses exceeding KES 80 billion.

Given the NSE's expanding role and the increasing complexity of financial markets, understanding how board characteristics affect audit quality is critical. This study seeks to examine the link between board composition and the likelihood of Modified Audit Opinions among NSE-listed companies. By doing so, it aims to contribute to the ongoing discourse on corporate governance and financial accountability in Kenya's capital markets.

## **1.2 Statement of the Problem**

Board characteristics play a massive role in shaping occurrence of MAOs by enhancing quality financial statements (Mandala,2018). In publicly listed companies, effective board governance is expected to minimize the risk of MAOs, which often signal deficiencies in financial disclosures, going concern issues, or non-compliance with accounting standards.

In Kenya, However, quality in financial reporting has continued to decline as demonstrated by Oruke et al. (2022) where 64.7% of companies received qualified reports with only 32% achieving unqualified and clean financial statements. Similarly, the Capital Markets Authority (CMA) and Institute of Certified Public Accountants of Kenya (ICPAK) have raised red flags over increasing incidences of financial misreporting, late disclosures, and audit qualifications among listed firms (ICPAK, 2022; CMA, 2023).

several studies have explored the relationship between corporate governance and MAOs in various contexts, including Serbia (Dordevic & Spasic, 2022), Macedonia (Srbinoska, 2022), and Malaysia (Omer et al., 2020). However, in Kenya, research on MAOs remains limited. The study by Oruke et al. (2022), for example, focused solely on State-Owned Enterprises (SOEs) and addressed corporate governance as a broad concept, without investigating specific board characteristics.

Additionally, many researchers have examined isolated board features, such as board size (Tarus, 2020), gender diversity (Singoei et al., 2021), or board diversity (Owen, 2018), producing inconsistent findings. For instance, Saaydah (2019) reported a positive association between board size and MAOs, whereas Ishak and Md Yusof (2015) found a negative relationship between professional board qualifications and MAOs.

Despite these efforts, there remains a clear gap in empirical research examining the effect of detailed board characteristics such as board size, independence, Board professional qualifications, and frequency of meetings on the occurrence of MAOs among publicly listed firms in Kenya. Most existing studies either focus on different sectors, such as SOEs, or assess corporate governance at a general level without considering the distinct attributes of boards.

This study, therefore, seeks to bridge this gap by investigating the influence of board characteristics on Modified Audit Opinions among companies listed on the Nairobi Securities Exchange. The findings are expected to inform both corporate governance practices and regulatory policies aimed at improving the quality of financial reporting in Kenya's capital markets

### **1.3 Research Objectives**

#### **1.3.1 General Objective**

The key objective of this study was to analyze the effect of board characteristics on modified audit opinion of companies listed at the Nairobi Security Exchange.

#### **1.3.2 Specific Objectives**

- i. To determine the effect of board professional qualification on modified audit opinion of companies listed at Nairobi Security Exchange.
- ii. To determine the effect of board independence on modified audit opinion on companies listed at Nairobi Security Exchange.
- iii. To determine the effect of the frequency of board meetings on modified audit opinion on companies listed at Nairobi Security Exchange.
- iv. To determine the effect of board size on modified audit opinion on companies listed at Nairobi Security Exchange.

### **1.4 Research Questions**

- i. Does board professional qualification affect modified audit opinion of companies listed at Nairobi Security Exchange?
- ii. Does board independence affect modified audit opinion of companies listed at Nairobi Security Exchange?

- iii. Does frequency of board meetings have an effect on modified audit opinion of companies listed at Nairobi Security Exchange?
- iv. Does board size have an effect on modified audit opinion of companies listed at Nairobi Security Exchange?

## **1.5 Significance of the Study**

This study established the effect of board characteristics on financial performance of companies listed at the Nairobi Securities Exchange in Kenya. The study looked forward to making numerous contributions to management, policy, theory, and scholars.

### **1.5.1 Practical Contributions for Managers**

Managers of the firms listed at the Nairobi Security Exchange may use the information obtained to make a strategic plan concerning board characteristic to limit the likelihood of having a modified audit opinion to attract investors and other users of the financial information. In addition, this study would help managers of the listed companies to conduct a healthy competition with other firms through product innovation and testing of new products. Managers would also be able to understand their customers and develop the best strategy to retain them, specifically by ensuring that the board characteristics meets the requirements required by the capital market authority to ascertain satisfaction levels.

### **1.5.2 Contribution to the Policy**

Policymakers aim to address challenges facing societies successfully. Through this research, the policymakers may identify the main challenges, estimate the impact and cost, and participate actively in the process of policy for better decision making. This study may further influence the policy makers through mobilization of knowledge which may help establish the research findings in developing policy within the requirements of the government in pursuit of the board

characteristics. The procedures created may also help to focus on the board characteristics as the main effect of the firm receiving a modified audit opinion.

### **1.5.3 Contribution to the Theory**

This study used some theories such as stakeholders', stewardship, institutional, and agency theories to generate forecasts and responded to research questions on the existing variables. Agency theory states that a company will be in a good position if the board characteristics is put in the correct place since its role is monitoring. There is some missing literature on how the board should be structured to limit the risk of receiving a modified audit opinion. This research will therefore help by adding to the existing literature.

### **1.5.4 Contribution to Scholars and Researchers**

Researchers and scholars interested in modified audit opinions may gain much from this research. The scholars can use the information provided as reference materials for future studies. The report may also add to the existing literature on the study topic. Taking several forms, taking multiple forms of research involves scholarly and creative ideas that can impact a new knowledge, improve problem solving ability, result in the development of a new theory and the formulation of recent artistic performance.

## **1.6 The Scope of The Study**

The goal of this research was to analyze the effect of board characteristics and modified audit opinion for the period 2015 to 2024. The 10-year period worked well because most companies had data in 2015 when the CMA repealed the 2002 ruling and issued a major new regulation governance of listed companies across the range. The 2024 period worked well because it was the most recent period in which data was published.

The study targeted all the 63 firms listed on the Nairobi Security Exchange as at 21st June 2024 and used 46 listed firms with existing data. The variables under study were; board size, board independence, frequency of board meetings and board professional qualification. Nairobi Security Exchange is a significant contributor to the economy. It is, therefore, necessary to note elements that could result in the collapse of some of its firms, such as the issue of modified audit opinion.

## **CHAPTER TWO**

### **LITERATURE REVIEW**

#### **2.1 Introduction**

The implications of board characteristics on modified audit opinion of firms listed at the Nairobi Security Exchange are discussed in this chapter's review of related literature. It began with a theoretical analysis of a number of theories concerning the study's variables. The conceptual framework highlighted potential relationships between the independent and dependent variables, empirical analysis, criticism of the body of literature, and research gaps. The chapter concluded by presenting the operationalization definition of the variables.

#### **2.2 Theoretical review**

Thomas (2017) states that a theory is a collection of connected generalizations pointing to fresh facts that can be put to the test empirically in order to explain or forecast. The listed companies' deliberate objective is to fulfill the wants and requirements of the stockholders. Four theories guided this study; the theory of the agency (Jensen & Meckling, 1976), theory of the stakeholders (Freeman, 1984), Institutional theory (Meyer & Rowan, 1977) and Stewardship theory (Donaldson & Davis, 1991).

##### **2.2.1. Agency Theory**

The agency theory was the foundation for this study by Jensen and Meckling (1976). According to the theory, the principal-agent theory is the beginning of any corporate discussion. This theory suggests how a company's governance is based on the conflicts of the stakeholders' and managers' mutual interest. In the agency theory, the company's principal shareholders employ agents to work on their behalf. The managers or directors who are the agents of the shareholders are delegated

work by the principal. According to the agency theory, the agents are expected by the shareholders to perform duties and make rational decisions in the principal's interest (Jensen, 1993). Agency theory states that the agency problem is created in modern firms due to ownership separation from the management. Agency theory argues that there is a need for shareholders' protection since the agents do not often act in the interest of the shareholders who are not present (Fama & Jensen, 1983). Agency theory suggests that the presence of the board of directors will enhance the quality of financial reporting, which is another dimension for a modified audit opinion. This means that the board will minimize the chances of a firm receiving a modified audit opinion. In this regard, boards are viewed as a monitoring tool that reduces the agency problem (Ishak & Md Yusof, 2015).

The board characteristics is based majorly on agency costs. Fama and Jensen (1983) argue that for the boards to be effective, they should comprise largely of the outside independent directors in the managerial position in other firms. Moreover, the author argues that a board that includes members with high qualifications enhances the quality of financial reporting. Agency theory further posits that larger boards effectively achieve quality reporting. Corporate governance generally helps control misunderstandings between the shareholders and the management (K. Sehwat, Kumar, Lohia, Bansal & Agarwal, 2019). According Huu Nguyen (2020) a good and effective corporate mechanism helps mitigate agency costs since the investors will invest in well-governed firms. The suggested corporate mechanism to reduce agency conflict includes board size, board independence, enhanced fixed pay bonus, and board tenure (Mandala o. n., 2018). Despite the usefulness of the agency theory, it suffers from selfishness since it is only interested in opportunistic human behaviors ignoring other human motives.

The theory was helpful to this study since it highlighted how important board characteristics is in reducing agency costs. The board has been found to be the primary remedy for agency issues. Agency issues may relate to revised audit opinions. If the board composition is sound, the recipients of the information can keep their disputes to a minimum and the board will make wise decisions. By closely observing the managers' and shareholders' actions, the board helps to lessen information asymmetry. The likelihood of a corporation having a modified audit opinion will be lower with an effective board, increasing trust among investors and other information users.

### **2.2.1 Stewardship Theory**

The creator of stewardship theory was Donaldson and Davis (1991). The stewardship theory brings about an alternative perspective of agency theory (Mongeri, 2021). The stewardship theory criticizes the agency theory on why it ignored human behaviors which plays a major role in governance while concentrating on economics of an organization alone. The theory posits that the relationship between managers and shareholders cannot bring about conflicts and hence argues that the shareholders will get an equal share of the company's profit and therefore focus to maximizing its value (Donaldson & Davis, 1991). According to the theory, the primary goal of the executives is to create value on the cooperation in contrast with the agency theory whose aim is on personal interest. In addition, Donaldson and Davis (1991) argue that the managers who work in accordance with the goals of an organization have a high chance of achieving satisfaction and finding value meeting with the organizational objectives.

In view to the above arguments, stewardship theory is in agreement that smaller boards will be more effective than large board size contrary to agency theory which argues that large boards are more efficient. On the other hand, stewardship theory suggests that board independent does not matter but encourages boards to include CEO duality (Donaldson & Davis, 1991). Despite

the implication about the stewardship theory, it has also received some criticisms on why it ignores independence of the board which plays a key role in monitoring (Mandala o. n., 2018)

This theory was useful in this study as it identified other aspects on how board is structured so as to achieve an effective corporate governance. This theory implies other alternatives to explain the board's dilemmas to ensure transparency thus minimizing chances of obtaining a modified audit opinion. The theory was thus used to explain the impact of board characteristics on modified audit opinion.

### **2.2.3 Stakeholders Theory**

Freeman (1984) approved this theory as a development of the agency theory. The theory states that the performance of an organization is viewed in a wide and complex business environment. The shareholders are not the only members whose interests need to be protected instead, other stakeholders who may be affected include employees, suppliers, customers and the wider range of community (Freeman, 1984). The corporate governance was best evaluated from the stakeholder and shareholders perspective (Letza, Sun, & Kirkbride, 2004) . Donaldson and Preston (1995) supports the stakeholders' theory by arguing that managers obtain benefits from stakeholders in order to make wise decisions.

Wang and Dewhirst (1992) noted that boards have the responsibility of protecting the stakeholders' interest. The board ensures that the companies conform to the legal requirements such as accountability and transparency (Mwangi, 2018). The theory suggests that proper usage of resources would lead to attraction of investors. However, Blattberg (2013) argues that the theory has a limitation in that it assumes that stakeholders interest can be compromised against each other. This theory was crucial in control and accountability by firms and institutions such as the board of directors which was examined in this study.

The theory was linked with the current study as it helped managers to maintain a good relationship and attract their stakeholders. Most of the stakeholders in the firm are the investors. To achieve this good relationship, the boards should be structured in a particular way. Correct structure of the board will enhance good financial reporting which indicates lower chance of receiving a modified audit opinion.

#### **2.2.4 Institutional Perspective Theory**

This theory was authorized by Meyer and Rowan (1977) who suggested that environmental and social matter in the creation of an environment, influences the use of certain technologies and practices when seeking legality. Powell and DiMaggio (1983) indicate that the concepts of institutional theory give an understanding of analyzing the relationship between the organization and the environment. This theory is based on legitimacy rather than effectiveness of the aim of an organization (Kimani, 2017). According to Scott (1995) institutions are explained as “social structures with a higher degree of resilience”.

Klein (2002) argues that the boards’ characteristics are important in the business environment. Spira (2003) posit that, boards play a significant role in protecting the investors’ interests thus reducing the chances of information asymmetry. The functions of the board can be influenced by the environment that they are in which are influenced by the institutional assumptions. According to Scott (2008), institutional theory insists on myths, legitimacy and rational which is widely acceptable. In any government institution, the board enhances a good public sector governance through provision of objective assessment on whether resources are used effectively and whether the results are being obtained.

This theory is useful in this study as it considers cultures in an institution that affect business environment. In any institution, boards are considered as important elements. The effective boards ensure there is transparency and accountability in an institution and hence reduce the chances of receiving a modified audit opinion which will attract investors. The study used this theory to show the importance of boards and its influence on modified audit opinion to stakeholders.

### **2.3 Empirical Review**

A review of the empirical literature on the effects of board characteristics on modified audit opinion was included in this section from various context. This brought about a clear understanding of how variables affect the probability of receiving a modified audit opinion. It then identified the research gap that the study addressed.

#### **2.3.1 Board Professional Qualification and Modified Audit Opinion**

Board professional qualification refers to experience or attribute gained by an individual prior to joining board of a company. Professional qualification is important as it will enhance clarity and better decision making as it will enable consistency. There exists empirical evidence between board professional qualification and modified audit opinion;

Alkelani et al. (2020) examined the link between the risk management committee's features and the issue of a modified audit opinion of the Amman stock exchange between the years 2015 and 2018 in the Jordanian context. The characteristics employed to predict modified Audit Opinions were size, qualifications, meeting frequency, and independence. Risk qualification was measured by the aggregate number of Risk committees with dividing accounting and finance by the overall membership sitting on the Risk management committee. On the other hand, Risk size is indicated by the whole quantity of committee directors. Finally, further risk panel independence

was indicated by the proportion of independent non-executive participants to all RMC participants. In comparison, how frequently the board convenes is indicated by the aggregate number of meetups occurring year. The dependent variable was indicated by "1" if a firm received a modified audit and "0" if it's not (Alkelani et al., 2020). The study established that there was a negative influence of qualification of members and meeting frequency on Modified Audit Opinions. However, independence had a positive and significance influence. There was no impact of risk size on modified Audit Opinion. The study however had limitations in that it was researched in Jordanian context. The present study sought to research in Kenyan context.

Zaid Alkilani et al. (2019) examined the significance of audit committee traits on Jordan's modified audit opinion for the period between 2012 and 2017. The study employed a layout population of 117 listed firms at Amman Stock Exchange. The study employed four variables; expertise, independent, meeting and size. Modified audit opinion was used as an independent variable. The study analyzed variables using logistic regression method with findings that expertise influences the likelihood of receiving a modified audit opinion while size, meeting and independence had no impact.

Almaqtari et al. (2021) investigated how company governance practices affected the accuracy of financial reporting under Indian GAAP and Indian accounting standards. The study utilized 97 companies which are listed on the Bombay stock exchange and covered the period between 2014 and 2018. The corporate governance mechanism was considered as financial reporting served as the dependent variable. Corporate governance attributes considered were as follows (size of the board, board expertise, independence of the board) and the characteristics of the audit committee (size, expertise, independence). The board expertise was showed by the number of the board with financial and managerial ratio of knowledge to overall quantity of board

members. On the other hand, board independence was indicated by the number of independent members of the board as a percentage of the overall number of board members while board size was indicated by total number of board of directors' members. The dependent variable was indicated by the error term residuals' standard deviation. Ordinary least square, correlation and the analysis were done using descriptive statistics. The findings indicated that the board characteristics and audit committee size and independence have a major impact on the caliber of financial reporting. However, board diligence and board committee characteristics have a detrimental effect. Whereas Diligence of the audit function had no effect on the caliber of financial reporting.

Anastasia Chi-Chi and Ognenefegha Friday (2016), examined the connection between good corporate governance and accurate financial reporting of a sample of 5 companies spread across all the 3 sectors, the manufacturing, service and banking for the period between 2006 and 2015. Board experience, board size, external audit quality, board independence, and the standard of the audit were used as predictors of financial reporting quality (Anastasia chi-chi & Ognenefegha Friday, 2016). Econometric analysis method was employed to estimate the results. The outcomes showed that board experience, board size and the effectiveness of external audit had a favorable effect on financial reporting. However independent directors and audit had a negative influence on quality of financial reporting.

Ishak and Md Yusof (2015) studied the link between the traits of the risk management committee and modified audit findings for non-banking and non-financial companies listed on Bursa Malaysia. The data employed was from the yearly report of 300 firms between the year 2004 and 2009. The study used multivariate and descriptive methods to analyze data. Attributes used to predict modified audit opinions were board qualification, number of business segments, and board independence. The results showed that members possessing a high qualification reduced the

chances of a business that has its audit opinion amended. On the other risk management committee without independence members was most likely to obtain a modified audit opinion. The companies which had two or more businesses had a minimum risk of receiving a modified audit opinion.

### **2.3.2 Board Size and Modified Audit Opinion**

Farnha and Viana (2009) stated that board size is directly correlated with the issuance of modified audit opinion of a company. Therefore, board size is one of the major ingredients that influence the likelihood of receiving a modified audit opinion. Board size relates to the estimated number of directors on a company's board who have voting rights. Some firms work well with a large board size while others with a smaller board size. Every company needs to develop its desired number of boards. Adebisi (2017) studied the connection between board characteristics and the reliability of financial reporting for 15 listed banks in Nigeria accepting deposits between 2007 and 2018. The study used a sample of 6 deposit money banks in Nigeria. The study employed descriptive research design and regression to analyze data. It incorporated board independence and board size as measurement of board attributes. The board size was indicated by the number of board members who make up the board. On the other hand, the ratio of outside directors to total board members was used to gauge board independence (Adebisi, 2017). According to the findings, board independence and size have a favorable but little effect on the accuracy of financial reporting.

Saka and Jarbou (2015) examined the external auditors' characteristics, corporate governance and audit reporting quality on a population of 28 firms in Tunisia listed on Tunisia Stock Exchange for the year 2006 to 2013. The board characteristics examined were audit committee, board size outside directors and CEO duality. Audit committee and CEO duality were indicated as a binary variable where "1" if there existed audit committee and CEO duality and "0" if no existence. Directors' numbers were used to gauge the size of the board. Within the board,

outside directors was indicated by the number of outside directors to the total directors within the board. The dependent variable audit committee quality was indicated using both the audit accuracy and timely disclosure. Timely disclosure was indicated by the number of days between the end of the financial year and publication. Auditor's accuracy was taken as a binary variable measured by taking the value of 1 if audit issue was a modified one otherwise 0. (Saka & Jarboui, 2015). The study employed multivariate regression panel data. The study findings indicated that audit members have no influence on audit quality. Furthermore, board size had a negative and important impact on audit quality, CEO duality had a positive and significant influence on audit quality. However, this research used audit quality as a dependent variable while the present research sought to use modified audit opinion as a different dimension of financial reporting quality.

Farnha and Viana (2009) examined the link between board characteristics and modified audit opinion of a layout of Euronext listed companies and 91 observations for the firm year from 2002 to 2003. Board independence, board diligence and board size were used as predictors of Modified Audit Opinion. Board diligence measured by number of board meetings was found to have a negative impact on modified audit opinion. Moreover, independence of the board measured by proportion of non-executive members in the board was shown to have a negative impact on modified audit opinion while board size did not have statistically impact on the issue of modified audit opinions.

Ibrahim and Jehu (2018) explored the connection between informativeness of financial reporting quality and board composition on 576 non- financial firms listed on Nigeria Stock Exchange for the years between 2011 and 2016. The sample size used was 96 which had complete data. The independent variables used were board size, independent non-executive directors, and non-executive directors. The dependent variable, financial reporting quality was measured by

abnormal accruals (Ibrahim & Jehu, 2018). The author employed secondary data to obtain information. The study used multivariate regression method to estimate results. The findings indicated that both independent non-executive directors and the percentage of non-executive directors on abnormal accruals was detrimental and significant, which raises the standard of financial reporting, while board size had no significant influence.

Ballesta and García-Meca (2005) examined the association between audit qualification and corporate governance in Spanish listed firms in Madrid stock exchange for the years between 1992 and 2002. The study employed a sample of 32 firms and a logistic regression to estimate the results. The independent variables employed were board size, ownership concentration and family members on the board. Board size was indicated by the members of the board and ownership was measured by the percentage of shares owned by the board of director members (Ballesta and García-Meca, 2005). On the other hand family was used as a dummy variable where 1 represented if a family member was on board. The dependent variable was indicated by 0 if the judgment is unqualified and 1 if it is qualified. The results posit that board size has a major impact on qualified opinion. As opposed to that, members on the same family on the board have high chances of receiving a qualified audit opinion while ownership concentration has a positive influence on unqualified reports.

Rusmin et al. (2009) analyzed the relationship between, monitoring mechanisms and Auditor reporting behaviors using 200 Australian manufacturing companies listed on ASX as at June 2004. The study employed cross-sectional empirical model to test the hypothesis. The study used board size, board independence, leverage, client size, and return on investment as predictors of audit reporting behaviors (Rusmin et al., 2009). The findings indicated that board size had a negative and a significant association with auditor's opinion. On the other hand, independent

board's audit committee had a negative but not a significant influence on audit opinions while a positive and a significant influence of leverage and return on investment on audit opinions.

### **2.3.3 Board Meetings and Modified Audit Opinion**

This is one of the factors whose nature affects the probability of the firm receiving a modified audit opinion. It entails an official event of the board of directors of a company and any invited customers, gathered on occasion and at predetermined intervals to discuss significant subjects, review performance and carry out the boards legal business (Alkelani et al., 2020).

Ajibulu, Yahaya and Agpi (2021) studied the integrity of the board of directors of Nigerian quoted banks' financial reporting. The characteristics of the boards used included (the board size, tenure, and independence, frequency of, meetings, gender and expertise). The study employed a correlational research design with a sample of 12 listed deposited banks. Board tenure measured by the period of the time spent by the member at the board. The total number of board members served as a measure of the board's size. The number of independent board members present at the meeting served as a proxy for board independence. The study findings indicated that board tenure and board expertise had a negative influence on financial reporting quality. However, the size of the enormous board was advantageous for financial reporting, while board independence, board gender diversity and frequency of the meeting leads to quality financial reporting however the research used financial reporting quality as a dependent variable. The present study used Modified Audit opinion as different dimension of quality of financial reporting.

Rotich (2017) examined the relationship of the makeup of the board and the standard of financial reporting in all listed companies at the Nairobi Security Exchange. The independent variables employed were the size of the board, board independence and the frequency of the board meetings. The board size was indicated by the number of board of directors, the percentage of non-

executive board members served as a proxy for board independence, and the number of annual meetings served as a proxy for board meeting frequency. Moreover, financial reporting quality was indicated by high or low accruals. The findings showed that the board size has a positive influence regarding the standard of financial reporting while board independence had a negative influence on financial reporting quality. This study however used financial reporting quality while the current study used modified audit opinion as a different perspective of financial reporting quality.

Jouri (2016) analyzed the correlation between corporate governance and auditors' opinion in Tehran market security. The data used was from the 90 firms. This was the period between 2001 and 2008. From the findings, the study established that the relationship between auditors' opinion and corporate governance was significantly weak. There it was no findings however of a strong relationship between the variables.

Oroke et al. (2020) examined the impact of corporate governance on modification of audit opinion on state owned enterprises in Kenya. The study used logistic regression method to analyze data. The author used 25 state owned enterprises for the period between 2014 and 2016. Based on the results, the research showed that the number of audit committee meetings had a negative impact on the probability of receiving a modified audit opinion. The board independence showed a positive impact but statistically insignificant. The findings of the firm size showed a positive and significant influence on modified audit opinion.

### **2.3.4 Board Independence and Modified Audit Opinion**

The aggregate number of existing non-executive board members is what is used to measure board independence. A proportional number is produced by dividing the aggregate number of individual non-executive members by the overall number of members. (Pucheta-Martínez & De Fuentes, 2007). Board independence is important in improving the corporate governance disclosures and compliance (CMA, 2016). The management may pressurize the auditor on the type of the opinion to give leading to poor financial reporting. To avoid any influence, the auditors should act independently to provide a fair view report. There exists empirical evidence between a modified audit opinion and board independence;

Ishak and Md Yusof (2015) examined the extent to which the board of director's independence affects the chances of obtaining the modified audit report for non-banking and finance listed companies on Bursa in Malaysia between 2004 and 2007. Leverage, asset profitability, and company segment were also employed as control variables. Board independence was calculated by the percentage of independently non-executive directors on the board. Total debt served as a proxy for leverage, and the earnings to interest ratio, taxes, and extraordinary income to overall assets served as an indicator of asset profitability. Business segment was measured as 1 if the company had two or more companies' segments, and as 0 otherwise, and the dependent variable for the modified audit opinion was measured as 1 if it had been received. To solve the study variables, descriptive and multivariable data analysis were both used. It was discovered that there was a poor correlation between independent directors and the Modified Audit opinion. Similar results indicated that increasing leverage increased the likelihood of a modified audit opinion. However, the matter for Modified Audit Opinion is less prevalent in companies with

larger business segments. The setting for this research was however in Malaysia while the present study focused on Modified Audit Opinions in Kenya.

According to Saayda (2020), the author assessed how corporate governance and changes to the modified audit opinion on the Jordanian market related. The study concentrated on a population of 104 non-financial companies that were listed on the Amman Stock Exchange for a year (2015). Saayda (2020) adopted an analytical regression when analyzing data with SPSS. The dependent variable, modified audit opinion was proxied by 1 if it was modified and 0 if it was otherwise. Board meeting, board size, audit committee were taken as independent variables while firm size, firm profitability and investment representatives were used as the controls. The study's conclusions showed that the board's independence, board meetings, company size and board committee have no significance influence on modified audit opinion while board size had a favorable and a significant impact of modified audit opinion. On the other hand, firm's profitability had a negative influence on modified audit opinions while investors' representatives had a significant negative impact on modified audit opinions. This study however focused on Jordanian market context while the present study sought to analyze the effect of board characteristics and modified audit opinion on companies listed at Nairobi Security Exchange in Kenya.

Ibrahim and Abubakar (2019) investigated the association between the board characteristics and financial reporting quality of 15 listed deposited money banking on the floor of the Nigerian Stock Exchange for the years between 2007 and 2017. A sample of 6 companies were used. The study used descriptive research design and regression analysis methods. The study incorporated the board independence as attributes of the board. The number of board members in the company served as a proxy for board size, while the ratio of outside directors in relation to all

board members served as a proxy for board independence. The results of the study show that board size and independence have a favorable and negligible impact on financial reporting effectiveness.

Omondi (2021) studied how corporate governance affects the accuracy of financial reporting in non-governmental organizations in Nairobi County. The target population of the study was 285 registered companies for the period between 2016 and 2020. The study used a 74-person sample size basing on the slovins formula. The study was based on secondary sources of data. Descriptive statistics and regression analysis were used in the investigation. The variables used to describe corporate governance were board diversity and board independence. Additionally, firm size was employed as an independent variable, and the quality of the financial reporting was used as a dependent variable. The percentage of female directors on the board revealed the diversity of the board while board independence was measured by the aggregate number of directors (Omondi, 2021). The findings showed that board diversity had a positive but negligible impact on the quality of financial performance while board independence had a positive but negligible impact on the quality of financial reporting. The quality of financial reporting had no significant association with firm size.

## **2.4 Summary of the Research Gaps**

Using the above literature review, it was clear that more investigation was necessary on the effect of board characteristics on modified audit opinion of companies listed at Nairobi Security Exchange. The literature reviewed in the above section presented a divergent view on the link between the board characteristics and modified audit opinion thus revealing gaps. The gaps are revealed as a result of the context, method used and the conceptualization of variables. The gaps relating to methods included population, sample size, research design employed and the method used in data analysis. In terms of the contextual gaps, few have studied the topic in developing

countries and companies listed at Nairobi Security Exchange in Kenya. The conceptual gaps concern how the dependent and independent variables are connected. It should be highlighted that the majority of research have employed one or a small number of board qualities, like independent directors and board tenure, as a gauge for modified audit opinion. As of right now, the majority of research have characterized board attributes using just one criterion, like independence and experience. Additionally, the majority of studies used the dependent variable of financial reporting quality. There are no studies that have reformulated board characteristics or altered audit conclusions. Few research has already been contextualized in impoverished countries, while the majority have been in developed regions. Kenya is a developing nation; thus, this study needed to eliminate the conceptualization gap for variables by applying the board characteristics inside the context of Kenyan companies listed on the Nairobi Securities Exchange. The list below summarized prior research and identifies research gaps.

**TABLE 2.1****A List of the Research Gaps**

<b>Study the Research</b>	<b>Knowledge Gaps</b>	<b>Exactly how the present study fills the gap (s)</b>
Ishak and Md Yusof(2015). Board independence and modified audit opinion in Malaysia	Only considered independence and ignored other characteristics. The study context was in Malaysia.	The impact of other board characteristics and the impact on modified audit opinion were considered. The present study was contextualized in Kenya
Saaydah (2020). Corporate governance and modification of audit opinion on Jordanian market.	The context was in Jordanian market.	The present study was contextualized in Kenya.
Rotich (2017). Board composition and quality of financial reporting on companies listed at Nairobi security exchange.	The study used cross-sectional research design and explanatory research design.	Descriptive research methodology was used in the current investigation.
Adebiyi (2017). Board attributes and financial reporting quality of listed deposit money banks in Nigeria.	The context was in Nigeria.	The present study was conducted in Kenya.
Oruke et al. (2020). Corpportae governace and modification of opinions.	The context was in state owned enterprises.	The present study was conducted in companies listed at NSE.

**Source: Researcher (2025)**

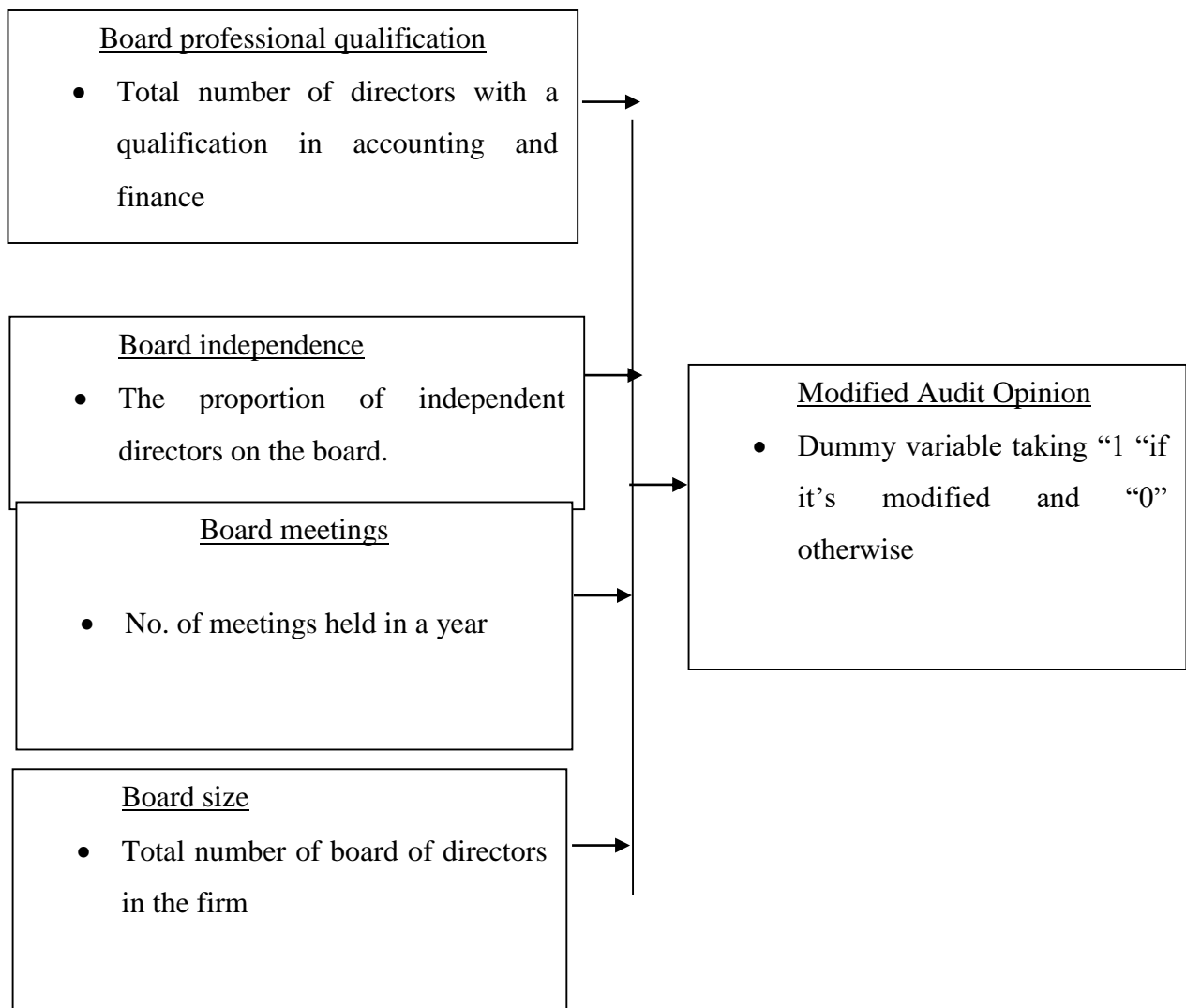
### **2.5 Conceptual Framework**

A conceptual framework is a visual or written presentation that illustrates key ideas, concepts, or variables and suggests potential relationships between them. The goal of this study was to ascertain how board characteristics of businesses listed on the Nairobi Securities Exchange that have capital market security licenses affect modified audit opinion. The study's independent factors were board

professional qualification, board size, board meeting and board independence. The dependent variable was modified audit opinion of listed companies. This relationship is represented in the figure 2.1 below.

**FIGURE 2.1.**

**Conceptual Framework**



**Source: Research (2025)**

## 2.6 Operationalization Study of Variables

The variables must be measured to enable answering the questions formulated. According to Nachmias and Nachmias (2004), the process of operationalization enhances empirical and quantitative measurement of variables. The study variables included board characteristics as an independent variable and modified audit opinion as a dependent variable. Table 2.2 below shows a summary of the operationalized variables.

**TABLE 2. 2**

### Operationalization of Variables

Research Variable	Type of variable	Measurement	Supporting Literature/Justification
Board professional qualification.	Independent variable	Total number of directors with a qualification in accounting and finance.	(Alkelani et al.,2020)
Board independence.	Independent variable	The proportion of independent directors on the board.	(Saaydah, 2020; Shatima,Babayo&Jamilu ,2020;Ishak &Md Yusof, 2015)
Frequency of board meetings	Independent variable	No. of meetings held in a year.	(Rotich, 2017)
Board size.	Independent variable	Total number of board of directors in the firm.	(Ibrahim & Jehu, 2018)
Modified audit opinion.	Dependent variable	This was evaluated based on the auditor general's opinion. This was coded with a Dummy variable where "1", if received modified audit opinion, otherwise "0".	(Farnha & Viana, 2009; Ibrahim & Jehu, 2018)

**Source: Research (2025)**

In this study the board characteristics was operationalized to include the attributes and functioning of the boards of directors. The board characteristics was explored using factors such as board

professional qualification, board independence, frequency of board meetings and board size. In these variables, board professional qualification was considered indicators such as academic qualification such as degrees, certifications and professional licenses. Also, professional qualification included professional experience, industry-specific knowledge, and training or development procedures availed to the board members.

In terms of operationalization of the study variables, modified audit opinion refers to one of the outcomes from an external audit conducted on an organization. In most cases, the report deviates from a standard unqualified opinion because of the identified deficiencies, discrepancies or limitations found in the financial statements or reporting. For this study, this variable was operationalized by considering the type of opinion, nature of modification, impacts on different stakeholders and frequency of the modified audit opinions.

## **CHAPTER THREE**

### **RESEARCH METHODOLOGY**

#### **3.1 Introduction**

This section outlines examples of the approaches which were used in this study to accomplish its goals. It detailed the study's methodology, intended audience, sample size, research instrument, and data collection procedure and model specification.

#### **3.2 Research Design**

A research design is a collection of techniques used to collect and analyze measurements of the elements stated in the research challenge (Kirumbi, 2018). To measure the trends of the data that is present in the references to the issue under study, this study used a descriptive research approach. An observation and description of a subject's characteristics are part of a descriptive study design without changing the subject in any way (Mugenda & Mugenda, 2003). The study adopted a descriptive research design since it enabled information to be gathered, organized, presented, and clarified. It was helpful in analyzing how the dependent and independent variables are related. The results of this study were applied to all businesses listed on the Nairobi Securities Exchange to determine how the board characteristics affects modified opinions.

#### **3.3 Target Population**

Corx (2013) states that the entire group of factors for which the study's data are utilized to make decision is the target population. This study targeted all the companies listed at Nairobi security exchange. The data from the Nairobi Securities Exchange showed 46 active listed firms at the Nairobi Security Exchange on June 8, 2021.

### 3.4 Sampling and Sampling Technique

The study used the given data for the listed companies during the selected period. The study utilized 46 listed companies after eliminating inactive companies and companies with missing data. The study employed census method of research. Census refers to a survey done on a complete set of the population (Monnot & Jorge, 2014). Census method minimized sampling error and no eligible data was left behind (Kothari, 2009).

### 3.5 Data Collection, Processing and Analysis

The annual financial reports provided secondary data from a 10-year period from 2015 to 2024. The data for the modified audit opinion was obtained from the website of companies listed at the Nairobi Securities Exchange. According to Patron (2020) data analysis involves evaluating data by the use of logical and analytical reasoning to check each unit of data provided which aids in inspecting, transforming, cleaning and modeling of data with an aim of finding important information and making conclusion.

The study used R software to perform a panel data analysis due to changes in variables and time. Hausman specification test was used to establish the appropriate model between random and fixed effects model. Equation (i) represents the direct effects of the independent variable on the dependent variable.

$$MAO_{it} = \beta_0 + \beta_1 Bpq_{it} + \beta_2 BIndep_{it} + \beta_3 FBmt_{it} + \beta_4 Bz_{it} + \epsilon \dots\dots\dots (i)$$

$MAO_i$  = Modified Audit Opinion per firm over time

$\beta_1, \beta_2, \beta_3, \beta_4$  are regression coefficients of the four independent variables

$Bpq_{it}$  = Board professional qualification per firm over time

$BIndep_{it}$  = Board independence per firm over time

$Bmt_{it}$  = Frequency of Board meeting per firm over time,  $\epsilon$  = Error term

### 3.6 Diagnostic Test

Panel data analysis bears assumptions; normality, multicollinearity, autocorrelation (Orlanes & Cuateros, 2020), homoscedasticity and Hausman test to establish which model is appropriate for analysis.

**TABLE 3.1**

**A List of Diagnostic Procedures**

<b>Essential Diagnostic Test</b>	<b>Statistical sample</b>	<b>Explanation</b>
Test for normality	Shapiro Wilk Test	Data is regularly distributed if p value is less than 0.05 Data is not normally distributed if p-value is greater than 0.05. The advantage for this test is that they offer concise summaries of the measurements and the sample (Egbert, 2015)
Test for Multicollinearity	Test of variation inflation factor	No multicollinearity is indicated by VIF between 1 and 10. Multicollinearity is indicated by VIF values greater than 10 or less than 1. Its advantage is that it helps to know if the data is correlated (Greenfield & Greener, 2016)
Test for Autocorrelation	Breusch Pagan LM	p-value < 0.05 means there is no autocorrelation. It can assist in figuring out whether a certain stock has a movement aspect at operation (Yevale, 2016).
Heteroscedasticity Test	Probability Ratio	Heteroskedastic is indicated by p-value less than 0.05
Model Specification	Hausman specification test	If p values are greater than 0.5 use fixed effects, if they are less than 0.5 use random effect.

**Source: Researcher (2025)**

## **CHAPTER FOUR**

### **DATA ANALYSIS, INTERPRETATION AND DISCUSSION**

#### **4.1. Introduction**

The study's purpose was to investigate the effect of board characteristics on modified audit opinion of listed companies at the Nairobi Security's Exchange. Four specific objectives guided the researcher: determining how board professional qualification affected modified audit opinion, board independence's effect on modified audit opinion, the effect of board meeting's frequency on modified audit opinion and to determine how board size affected modified audit opinion of listed companies in Nairobi Securities Exchange. This chapter presents the findings from the secondary data collected. The chapter is divided into four sections: response rate, descriptive statistics, diagnostic tests and binary logistic regression.

#### **4.2 Response Rate**

The study main sample was 46 listed companies where 10-year period (2015-2024) data on board characteristics was collected. However, there were companies which had published only five-year data in their website while others experienced technical challenges in the website that made it difficult to access all the 10-year data required. The researcher therefore excluded six companies and worked with 40 which had complete data for the period under review translating to 400 observations as indicated in Table 4.1.

**TABLE 4.1.**

**Response Rate**

<b>Companies listed</b>	<b>Observations</b>	<b>Return Rate</b>
40 Companies with complete data on financial reports	400	87%
6 Did not have all the data	60	13%
<b>46</b>	<b>460</b>	<b>100</b>

Source: Data (2025)

The result in Table 4.1, shows that the study response rate was 87% while 13% did not provide secondary data to support the research objectives.

### **4.3 Descriptive Statistics**

Descriptive statistics is an important step in data analysis prior to advanced inferential statistics ((Kaur *et al.*, 2018). The study used descriptive statistics to discover patterns existing in the data which had four independent variables: Board Professional Qualification, Board Independence, Board Size and Board Meeting Frequency. The dependent variable was a dichotomous with two outcomes: 0 and 1. The dependent variable was converted to a dummy variable prior to analysis as part of data processing. Measures such as minimum and maximum were used to identify the highest and the lowest occurrence of the variables within the period under review (2015-2024) for all the 40 companies listed at Nairobi Securities Exchange. The researcher used mean and standard deviation as demonstrated in Table 4.2.

**TABLE 4.2.****Descriptive Summary Statistics**

<b>Board Characteristics</b>	<b>Obs</b>	<b>Min</b>	<b>Max</b>	<b>Mean</b>	<b>Std. Dev.</b>
Board Prof Qualification	400	1	8	3.368	1.3664
Board Independence	400	1	10	3.8030	1.5393
Board Size	400	2	18	9.1200	2.5152
Board Meeting Frequency	400	2	13	4.7680	1.6569
MOA	400	0	1	0.5000	0.5006
<b>Total</b>	<b>2000</b>	<b>6</b>	<b>50</b>	21.559	7.5784

Source: Data (2025)

From the findings displayed in Table 4.2, there were companies which had a minimum number of one (1) board member with professional qualification in accounting and finance while there were other companies with a maximum of eight (8) board members with professional qualification in accounting and finance. The mean for professional qualification was 3.37 with a standard deviation of 1.37 hence indicating that companies recognized the importance of professional qualification in accounting and finance in the improvement of audit quality which reduces chances of obtaining modified audit opinion. Shukri and Abdallah (2022) reported how professional qualification of the board enhances directors' understanding on audit procedures and audit risks. This study established that companies listed at the Nairobi Securities exchange have an average of 3 board members with professional qualification in finance and accounting which improves quality financial statement and lowers chances of getting modified audit opinion.

The results in Table 4.2 showed that the minimum number of independent boards was just one (1). However, there were companies which had a maximum of 10 independent board members. The mean number of independent board members was 3.803 with a standard deviation of 1.54. This shows that all companies had atleast 4 members who could provide independent opinion on financial information and hence influence modified audit opinion of companies listed at the Nairobi Securities Exchange.

Independent board members must not be previously engaged with the company and should not have professional involvement with the organization. Additionally, independent board engages with the general wider stakeholders which make them capable of inducing effective oversight thereby limiting modified audit opinion (Ong, 2016). The presence of independent board members in listed companies at Nairobi Securities Exchange demonstrate the effort companies are putting in place to lower chances of getting modified audit opinion through independent observations. Saaydah (2019) investigation recognized how board independence contributed to modified audit opinion for companies in Jordanian market which agrees with the current study evidenced in the inclusion of independent members in the company's board of directors.

The study found that board size had a minimum number of 2, and a maximum size of 18. The mean was 9.12, standard deviation of 2.52. This showed that the number of board members vary according to the nature, industry and size of companies. However, the results showed that largely, company board size comprises of 9 members who provide different views on financial matters of the company and hence influence modified audit opinion of listed companies at the Nairobi Securities Exchange. Saaydah (2019) reported 13 as the maximum size of board members in the Jordanian market, a minimum of 4 while the average was 9. Even though Kenyan market

has a maximum number of board members at 18, the minimum is 4 with a mean of 9 which is similar to previous study thereby agreeing with the current research.

The study findings from Tabel 4.2 indicate a minimum frequency of board meetings at 2, while the maximum frequency of meetings for board members is 18 per year. However, the mean frequency of meetings was 4.77 with a standard deviation of 1.66. The results demonstrate that at least 4 meetings are held yearly by most companies as required by the regulator. However, according to companies' activities and business environment requirement, there were up to 18 meetings held per financial year. The findings show that companies listed at Nairobi Securities Exchange conduct regular meetings which help in discovering trends in the market and financial risks and therefore enabling companies to make informed decisions to reduce chances of obtaining modified audit opinion. Apadore and Utara (2020) study on board characteristics and audit lag reported an average meeting of 5 per year, minimum of two meetings with a maximum of 17. This showed that companies conduct regular meetings according to their activities which agrees with the current research.

The findings demonstrate that modified audit opinion at the minimum was zero, indicating that companies at Nairobi Securities Exchange did not have cases of modified audit opinion. However, the maximum number was 1, signalling presence of modified audit opinion among companies listed at the Nairobi Securities Exchange. The mean was 0.5000, standard deviation of 0.5006, thereby implying that companies had 50% likelihood in obtaining modified audit opinion.

## **4.4. Diagnostic Tests**

Panel data comprises a data set with a particular sample of entities that are observed for a given duration of time hence providing multiple observations for each entity (Hsiao, 2022). Panel data has both time series and cross-sectional dimensions that present potential for multicollinearity and heteroskedasticity (Ramdan et al., 2020). The researcher performed diagnostic tests prior to panel data analysis to meet regression assumption for panel data; normality test, multicollinearity test, heteroskedasticity test, auto correlation test and Hausman test,

### **4.4.1 Normality Test**

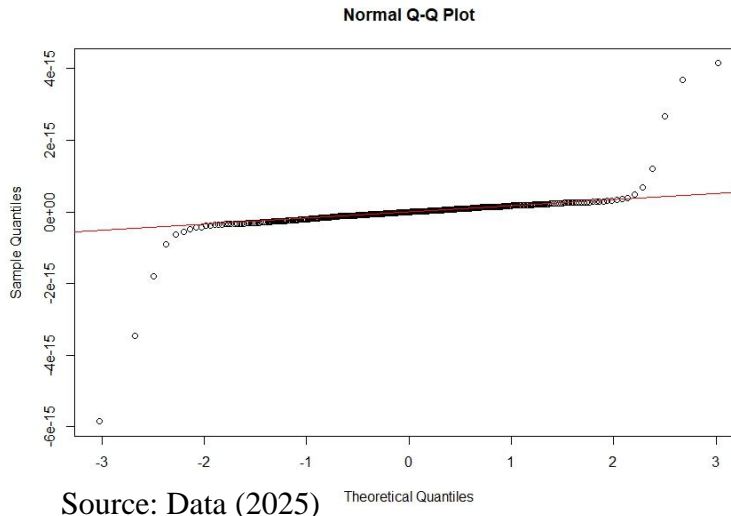
Normality test is used to establish whether the data is generated from normal distribution (Yang & Berdine, 2021). Graphical and statistical methods may be used to detect normality in a given data set.

#### **4.4.1.1. Q-Q Plot**

Quantile-Quantile is a graphical representation of data distribution which determines whether data comes from a normal distribution (Habibzadeh, 2024). The Q-Q plot compares observed data with its expected theoretical distribution where the observed values are displayed in the x-axis while expected are visualized in the y-axis. Observed data with normal distribution tends to follow a straight line hence indicating that points observed along the x axis are similar to those estimated on the y-axis. Where there is presence of departure from normal distribution, it can be concluded that data is generated from normal distribution (Guzik & Wieckowska, 2023). Figure 4.1 represents the Q-Q plot. Q-Q plot was used to visualize normality as indicated in Figure 4.1.

**FIGURE 4.1.**

Q-Q Normality Plot



From Figure 4.1, data set follows a non-normal distribution as not all the observations follow a straight line. A statistical test (Shapiro Wilk and Jarque Bera) was done to confirm data distribution presented in the Q-Q plot.

**4.4.1.2 Normality Test with Shapiro Wilk**

Shapiro Wilk was used to establish the normality in data. The null hypothesis was that data is from normal distribution while the alternative was that data is derived from non-normal distribution (Yang & Berdine, 2021). Table 4.3 presents the normality statistics.

**TABLE 4.3.**

**Shapiro Wilk Test**

Shapiro-Wilk Test		Jarque Bera Test		
W	P_value	X-squared	df	p-value
0.41965	2.2e-16	79156	2	16

Source: Data (2025)

From the analysis in Table 4.3, Shapiro Wilk statistic was 0.41965 with a p value less than 0.05. The outcome show that Jarque Bera test had X-squared value of 79156 with a p value below 0.05. This indicates the two diagnostic normality tests proved that the data was did not come from normal distribution. In data sets with large sample, normality may not be crucial regardless of normality test (Demir, 2022) hence the data was used to perform panel data analysis.

#### 4.4.2. Multicollinearity Test

Multicollinearity occurs when there is a strong connection between explanatory variables which may lead to serious problems in parameter estimation and its interpretation (Oke et al., 2019). The study used Variance Inflation Factor (VIF) to detect presence of multicollinearity in the independent variable-board characteristics. The findings are presented in Table 4.4.

**TABLE 4.4.**

#### **Multicollinearity Detection**

<b>Variable</b>	<b>VIF</b>
Board Professional Qualification	1.697757
Board Independence	1.468465
Board Size	1.416914
Board Meeting Frequency	1.012764

Source: Data (2025)

From the findings in Table 4.4, it is clear that all the variables do not have multicollinearity: Board Professional Qualification VIF was 1.697757, Board Independence had VIF of 1.468465, Board Size had a VIF of 1.416914 while Board Meeting Frequency recorded a VIF of 1.012764. From the results, all the VIF values were below 10 which signalled no multicollinearity hence data

was considered suitable for advanced analysis in panel data analysis. Omer *et al.* (2020) suggest that VIF values  $>5$  is an indication of moderate multicollinearity while above 10 demonstrate serious multicollinearity. The authors found a VIF of Board Size at 1.60, Board Meeting was 1.15 while Board Professional Qualification was 1.05. This study offers similar findings with Omer *et al.* (2020) as board characteristics do not have multicollinearity among the explanatory variables.

#### 4.4.3. Heteroskedasticity Test

Heteroskedasticity should not be ignored in data analysis as it may lead to inefficient approach to data analysis. Heteroskedasticity analyses the error term to determine if the data has panel effect where  $p \text{ value} > 0.05$  leads to acceptance of the null hypothesis as the error terms are constant in all study observations. If the error terms are constant, it demonstrates homoscedasticity (Abdul-Hameed & Matanmi, 2021). In heteroskedastic analysis, the null hypothesis is that there is homoscedasticity against the heteroskedasticity at 5% significance level. Heteroskedasticity measures any inequality of residuals and variance from one observation to another where there is a fixed observation, homoscedasticity exists otherwise difference demonstrates heteroskedasticity (Ilham *et al.*, 2022). Table 4.5 is the finding for heteroskedasticity diagnostic test.

**TABLE 4.5.**

#### Heteroskedasticity Test

Breusch-Pagan Test		
BP	df	p-value
9.0851	13	0.7665

Source: Data (2025)

The results from Table 4.5 reveal that Breusch Pagan test statistic was 9.0851, degrees of freedom (df) of 13 with a probability of 0.7665. Abdul-Hameed and Matanmi (2021) state that if the error term is constant the null hypothesis ( $p\text{-value} < 0.05$ ) is accepted a demonstration of homoscedasticity otherwise reject the null hypothesis. The results indicate that the p value was above the cut off of 0.05 hence heteroskedasticity was absent as the error terms appeared constant thereby fulfilling the assumption.

#### 4.4.4. Autocorrelation Test

Autocorrelation measures any relationship between errors in period t and period t-1. The model should not have any autocorrelation. Durbin Watson test was used to test autocorrelation. The value of D-W should be within -2 and 2 to demonstrate absence of autocorrelation (Ilham et al., 2022). The results are presented in Table 4.6.

**TABLE 4.6.**

#### **Autocorrelation Test**

Chisq	df	p-value
150.48	10	2.2e-16

Source: Data (2025)

The outcome in Table 4.6 show that Chisq was 150.48 while the p value was below 0.05. Chaudhary et al. (2022) note that the probability value should not be less than 0.05 when there is no autocorrelation. From the analysis, the p value of less than 0.05 implies that the data had serial autocorrelation.

#### 4.4.5. Hausman Test

The Hausman test is used to compare and choose an appropriate model for panel data analysis between fixed effect and random effect (Sheytanova, 2015). Hausman diagnostic test is important in identifying a model with consistency outcome (Ilham, 2022). The outcome is illustrated in Table 4.7.

**TABLE 4.7.**

**Hausman Test**

<b>Hausman Test</b>		
Chisq	df	p-value
1122.5	13	2.2e-16

Source: Data (2025)

From the Table 4.7, the Chi Square is 1122.5 with a p\_value less than 0.05. Kadarova et al. (2022) states that where p value is greater than 0.05, a random effect model may be used in panel data analysis otherwise fixed effect model for p-values below 0.05. However, the findings demonstrate Hausman statistics below the threshold of 0.05 and hence the study adopted fixed effect model to investigate how board characteristics affect modified audit opinion of companies listed at the Nairobi Securities Exchange.

## **4.5. Panel Data Analysis**

The study used panel data analysis to analyse the relationship between variables. Data was first transformed into natural logarithm and converted into panel data frame. A dummy variable was created for time and company element in R software. The panel linear model function (plm) was used in the analysis of fixed effect and random effect from where fixed effect model was used in the analysis.

### **4.5.1. Fixed Effect Model**

The fixed effect model assumes distinctive effects for each particular company. The study used the plm() function and “within” method in R to perform panel data analysis where the coefficients and probabilities values were presented to demonstrate the effect of the explanatory variables on the dependent variable-modified audit opinion. The t.test was used to establish the effect of each independent variable on modified audit opinion while the F statistic enabled the determination on whether the model was effective in predicting modified audit opinion. Table 4.8 presents the analysis.

**TABLE 4.8****Fixed Effect Model**

Variables	Coefficient Estimates	Std.Error	t-value	Pr(> t )
Board Prof Qualification	-1.4001e-16	1.1914e-16	-1.1752e+00	0.2407073
Board Independence	-2.0283e-16	1.0686e-16	-1.8981e+00	0.0585122 .
Board Size	5.8383e-16	1.7007e-16	3.4330e+00	0.0006692 ***
Frequency of Meeting	-1.0826e-15	1.7367e-16	-6.2339e+00	1.320e-09 ***
R Square	1.			
Adjusted R Square	1.			
F-statistic	2.61697e+31			
P-value	2.22e-16			

**Source: Data (2025)**

The results in Table 4.8 show that Board Professional Qualification coefficient was (1.4001) with a p value of 0.240. This indicates a negative relationship where an increase in Board Professional Qualification decreases modified audit opinion by 1.4001. The high p value of 0.240 is a signal that the variable does not lower modified audit opinion significantly. The results agree with Wa-Hussin and Bamahros (2013) who noted how board professional qualification did not have any significant effect on Malaysian companies. The outcome also complies with Alkalani et al. (2020) who found a negative effect of board qualification on modified audit opinion when Jordanian Amman Stock Exchange companies were investigated. However, the results do not agree with Shukri and Abdullah (2022) who investigated Malaysian companies analysing the period of 2013-2019 and reported significant effect of board expertise on audit quality.

The outcome in Table 4.8, demonstrates that having all factors constant, modified audit opinion will reduce significant by (-2.0283, p value 0.05) upon the introduction of Board Independence in the model. The negative sign is an indication of negative relationship between Board Independence and Modified Audit Opinion. The findings therefore imply that companies at Nairobi Securities Exchange have incorporated Board Independence to significantly reduce modified audit opinion.

The findings displayed in Table 4.8, do not confine to Saidu and Aifuwa (2020) who reported how independent board members did not have significant effect on audit quality of Nigerian listed companies which appears contrary to the current research as there is a negative and significant effect of board independence on modified audit opinion of listed companies in Nairobi Securities Exchange. Board independence is important as it may deter manipulation of financial results, reduce distortion of financial reporting and improve quality of financial reporting. However, with weak governance, board independence may not help improve financial reporting quality and therefore increase modified audit opinion. Nabar et al. (2009) observed how weak board may produce inferior independent members who may not be able to offer independent opinion and therefore increase modified audit opinion (Saleh *et al.*, 2021). The outcome has sufficient evidence that Independent Board members significantly lower modified audit opinion of companies listed at the Nairobi Securities Exchange.

The findings in Table 4.8, reveal that Board Size introduction into the fixed Effect model increases modified audit opinion significantly by 0.8383, p value 0.000. This demonstrates a positive relationship and hence companies at Nairobi Securities Exchange may increase modified audit opinion when they incorporate a higher board size. The outcome complies with Moses (2019) who reported how board size had a significant effect in financial reporting quality of 15 Nigerian

banks. However, the findings do not agree with Farnha and Viana (2009) study of listed firms in Euromax who discovered that board size did not have significant effect on modified audit opinion. The result does not conform to Ibrahim and Jehu (2018) investigation who reported that board size did not have significant effect on modified audit opinion of listed firms in Nigerian Stock exchange. The results are also contrary to Adebisi (2017) who found that Board Size had less effect on financial reporting of listed firms in Nigeria while Saka and Jarboul (2015) research indicated a significant negative effect of board size on audit quality which is not in agreement with the current findings.

Muthuva *et al.* (2019) observed that larger board size may need more time to oversee managerial function and producing reports. Larger board size may also introduce complications in coordination and decision making thereby hamper quality financial reports. This shows that Board size is important in determining modified audit opinion for companies listed at the Nairobi Securities Exchange hence companies should adopt optimum Board Size to limit modified audit opinion.

The revelation in Table 4.8, demonstrates that the introduction of Board Meeting into the regression model significantly reduces chances of obtaining modified audit opinion by (-1.0826,  $p$  value < 0.000) and hence the more there are board meetings, the less the modified audit opinion for companies listed at the Nairobi Securities Exchange. Ajibulu *et al.* (2021) demonstrated the significant role board meeting plays in enhancing the quality of reporting for Nigerian banks which agrees with the current research findings. The findings also agree with Oruke *et al.* (2020) who found a negative effect of board meetings on modified audit opinion for state corporations in Kenya. From the results, the model was;

Agency theory proposed by Jensen and Meckling (1976) states that the board of directors are delegated roles by the principal where they make rational decisions for the benefit of the principal. Independent directors are not employees and do not have professional engagement prior to becoming part of the company's board which helps in maintaining objectivity by providing independent views regarding company financial matters to protect the interest of the principal and therefore reduce any conflict that may arise in agency relationship due to modified audit opinion. Even though the Stewardship theory recommended by Donaldson and Davis (1991) view independent board as insignificant in enhancing quality of financial reporting. Agency theory supports the findings where Board Independence demonstrates a significant negative relationship with Modified Audit Opinion. This implies that with high number of Independent Board, rational decisions are made which lowers Modified Audit Opinion. This reveals objectivity exhibited by Independent Board in their judgment which helps in representing the principal's interests.

Stakeholder theory advanced by Freeman (1984) states that an organization should consider other stakeholders who may be affected by its activities. Mwangi (2018) suggests that the board should be structured with an aim of fostering strong relationship with stakeholders. Board of directors of listed companies at Nairobi Securities exchange are constituted according to the needs of the organization while serving different stakeholders' needs. The board's different professional qualification, size, presence of independent directors and regular meetings are critical in responding to diverse organization's stakeholders' requirements and therefore fulfilling stakeholder theory proposition by; conforming to legal requirements, meeting shareholder investment needs, protecting the interests of clients, employees and the general stakeholder needs.

The institutional theory proposed by Meyer and Rowan (1977) recognizes the significant role the board plays in reducing information asymmetry (Spira, 2003). However, the theory

observes how the board are influenced by their environment in decision making where culture plays a great role in shaping the board’s behaviour in decision making. The results from the study show how frequency of board meetings helps in exposing the companies to emerging issues in the environment, identification of audit risk and business performance which are essential in providing information thus lowering modified audit opinion. Regular board meetings demonstrate commitment to supporting the companies in overcoming environmental challenges that may influence modified audit opinion.

#### 4.5.2. Random Effect Model

**TABLE 4.9**

**Random Effect Model**

Variables	Coefficient Estimates	Std. Error	t-value	Pr(> t )
Board Prof Qualification	-4.3089e-16	1.5013e-16	-2.8702e+00	0.0041024 **
Board Independence	4.6225e-17	1.3469e-16	3.4320e-01	0.7314478
Board Size	-2.8809e-17	2.1430e-16	-1.3440e-01	0.8930607
Frequency of Meeting	-1.4559e-16	2.1877e-16	-6.6550e-01	0.5057381
Constant	1.0000e+00	9.8020e-16	1.0202e+15	2.2e-16 ***
R-Square	1			
Adjusted R Square	1			
Chisq	2.13454e+32			
P-value	2.22e-16			

**Source: Data (2025)**

The outcome in Table 4.9, demonstrates that when all factors remain constant, modified audit opinion will go up by 1.00, p value <0.05. however, when Board Professional Qualification is added into the Random Effect (RE) model, Modified Audit Opinion reduces by (-4.3089, p value 0.04). This demonstrates a negative connection where the more companies listed at the Nairobi Securities Exchange incorporates Board Professional Qualification to reduce modified audit opinion.

The results in Table 4.9, indicate that Board Independence introduction into the model raises modified audit opinion by (4.6225, p value=0.731). the high p value of 0.731 imply that Board Independence does not have significant effect in the Modified Audit Opinion for companies listed at the Nairobi Securities Exchange.

The findings in Table 4.9, show that Board Size incorporation in the RE model reduces Modified Audit Opinion by (-2.880, p value of 0.893) thereby no significant effect in the reduction of dependent variable.

The outcome in Table 4.9, shows that when Board Meeting is added into the RE model, companies listed at Nairobi Securities Exchange will reduce modified audit opinion by (-1.4559, p=0.5057). The negative coefficient implies a negative relationship between Board Meetings and Modified Audit Opinion. The R Square showed a perfect relationship where Board Characteristics have perfect connection with Modified Audit Opinion.

#### 4.6 Research Questions

The study had four research questions that were developed from the study's specific objectives. The first question was based on whether board professional qualification affect Modified Audit Opinion of companies listed at the Nairobi Securities exchange. The findings revealed that Board Professional Qualification had ( $\beta = -1.4001$ ,  $p \text{ value} = 0.240$ ) hence showing that the variable did not significantly affect Modified Audit Opinion of listed companies at the Nairobi Securities Exchange.

The second question was "does Board Independence have an effect on Modified Audit Opinion of listed companies at the Nairobi Securities Exchange? The results showed that Board Independence significantly ( $\beta = -2.0283$ ,  $p \text{ value} = 0.05$ ) affected Modified Audit Opinion of companies listed at the Nairobi Securities Exchange.

The third question on whether Board Size had an effect on Modified Audit Opinion of companies listed at Nairobi Securities Exchange. The findings showed that Board Size has a significant effect ( $\beta = 5.8383$ ,  $p \text{ value} = 0.000$ ) on modified audit opinion.

The last research question was on whether Board Frequency of Meetings have an effect on Modified Audit Opinion of companies listed at Nairobi Securities Exchange. The outcome showed a significant effect ( $\beta = -1.0826$ ,  $p \text{ value} = 0.000$ ) thereby, indicating that Board Meetings have significant effect on Modified Audit Opinion of companies listed at Nairobi Securities Exchange.

## **CHAPTER FIVE**

### **SUMMARY, CONCLUSION AND RECOMMENDATION**

#### **5.1. Introduction**

This chapter makes summarization of the findings according to the research objectives. The chapter presents conclusion and highlights recommendations for policy and practice. The purpose of the study was to investigate the effect of board characteristics on modified audit opinion of companies listed at the Nairobi Securities Exchange. The researcher was guided by four specific objectives; to determine board professional qualification on modified audit opinion, to determine how board independence affect modified audit opinion, to determine the effect of frequency of board meetings on audit opinion and to determine the effect of board size on modified audit opinion of companies listed at the Nairobi Securities Exchange. The study used secondary data of the companies' financial reports generated between 2015-2024. A total of 40 companies with 400 observations were made. Panel data analysis was employed in data analysis.

#### **5.2. Summary of Findings**

The study purposed to investigate the effect of board characteristics on modified audit opinion where four variables were used: board professionalism, board independence, board size and board frequency of meetings. The results proved that Board Professionalism, Board Independence and Frequency of Board Meetings have a negative relationship with Modified Audit Opinion while Board Size demonstrated a positive significant effect on modified audit opinion. The findings on specific objectives are summarized:

### **5.2.1 Board Professional Qualification and Modified Audit Opinion of Listed Companies**

The first objective was to determine how board professional qualification affect modified audit opinion. The findings suggest that companies listed at the Nairobi Securities Exchange have atleast a board member with qualification in accounting and finance, a maximum of 8 with a mean of 3. Fixed effect model revealed that Board Professional Qualification had an insignificant negative effect on modified audit opinion.

The study does not agree with Lo *et al.* (2010) who reported a positive and significant effect of financial expertise on quality of reporting. Khudhair *et al.* (2019) observe the importance of board competency in meeting requirements of financial reporting by enhancing quality. The authors add that board members with expertise in finance and accounting offer immense benefit to stakeholders as they provide true position on financial status of the firm, and improve oversight capacity of the audit committee hence communicating to investors the quality of financial reporting they seek. The current research shows that listed companies have required skills in the board of directors hence are capable in providing essential oversight needed in producing quality financial reports thus influence modified audit opinion.

### **5.2.2. Board Independence and Modified Audit Opinion of Listed Companies**

The second objective was to ascertain how board independence determines modified audit opinion. The result demonstrates how companies have incorporated independent board of directors where atleast 3 are enlisted in the board with a maximum of 10 working as independent board members. The outcome further confirmed the significant role independent board play in reducing modified audit opinion. Moradi *et al.* (2024) established a negative effect of board independence on modified audit opinion which is confines to the current outcome. This means that the more independent members are added in the board, the lower the chances of obtaining modified audit

opinion. The findings are contrary to Ishak and Yusof (2015) who observed no significant effect of board independence on modified audit opinion (Saaydah, 2019).

### **5.2.3. Board Size and Modified Audit Opinion of Listed Companies**

The third objective was to determine the effect of board size on modified audit opinion. The study established that companies listed at the Nairobi Securities Exchange have a maximum of 18 board, with an average of 9 members of the board. Alabdullah *et al.* (2019) reported a maximum of 8 board members which is contrary to Kenyan listed companies with maximum of 18. This however, depends on the nature of the company, its size and regulations existing per geographical region. The fixed effect model showed a positive significant effect of board size on modified audit opinion hence, implying that larger board size increased modified audit opinion of companies listed at the Nairobi Securities Exchange.

Moradi *et al.* (2024) reported a positive significant effect of board size on modified audit opinion which is in line with the current study findings. The current findings confine to Saaydah (2019) who also reported a positive significant effect of board size on modified audit opinion which means that when the size is enhanced, obtaining modified audit opinion increases. Moradi *et al.* (2024) add that the more the board size, the less effective it is in monitoring activities thereby hampering quality in financial reporting. However, the number of board members helps in bringing different critical skills necessary in enhancing quality of financial information thus affect modified audit opinion.

#### **5.2.4. Board Frequency of Meeting and Modified Audit Opinion of Listed Companies**

The last objective was to determine the effect of frequency of board meetings on modified audit opinion of companies listed at the Nairobi Securities Exchange. The findings show that most companies had 4 meetings with a maximum of 13 per financial year. Panel data analysis revealed the critical role played by board meetings in modified audit opinion by detecting emerging issues that may affect quality of financial reporting. The findings also showed that there needs to be more board meetings as it has a negative effect on modified audit opinion as the more meetings are held, the more chances companies have to reduce challenges that may lead to modified audit opinion.

The outcome agrees with Bryan *et al.* (2004) who noted a significant effect of board meeting in financial quality outcome. Smith Committee (2003) note that regular meeting is crucial where responsibilities and roles should be defined while Abott *et al.* (2004) recognized how there are reduced problems when board members hold regular meetings which lowers the modification of audit opinion. The current findings agree with previous studies as there is a negative effect and hence indicating with more meetings, there is likelihood of spotting areas of concern in audit process for improvement purposes thereby lowering modified audit opinion.

### **5.3. Conclusion**

On the first objective, the value of professional qualification in accounting and finance is recognized by companies listed at Nairobi Securities Exchange as they have incorporated at least 3 board members with professional qualification in finance and accounting hence critical in enhancing financial information quality thus reducing modified audit opinion. Professional qualification however, does not have significant effect on modified audit opinion for companies listed at the Nairobi Securities Exchange.

The study makes conclusion that board independence plays a critical role in modified audit opinion where companies have incorporated an average of 3 independent board members with ten as the maximum number. The number of independent board members are critical in lowering modified audit opinion as the higher the number, the less modified audit opinion is experienced.

It is concluded that board size enhances the diversity of board members, enabling a mixture of skills and creativity needed in the improvement of quality financial information. Listed companies at Nairobi Securities Exchange have therefore enhanced the number of board size upto 18 to bring in more opinion of board members that lowers modified audit opinion. However, the study concludes that larger board size significantly increases modified audit opinion of companies listed at Nairobi Securities Exchange.

The study concludes that frequency of board meetings is crucial in reducing modified audit opinion evidenced in the number of meetings where atleast four with a maximum of 13 meetings are held yearly by companies listed at the Nairobi Securities Exchange. Board meetings have significant effect in the outcome of modified audit opinion as the more meetings are held, the less the chances in obtaining modified audit opinion.

## **5.4. Recommendation**

### **5.4.1. Theoretical Recommendations**

The study offers valuable contribution to theory development while observing board characteristics over a ten-year period while focusing on modified audit opinion of listed companies at Nairobi Securities exchange. The agency theory has been reinforced through board frequency of meetings, board independence and board professional qualification that lowers modified audit opinion thereby protecting the interests of the principal. The theory has been improved by

recommending the need for a minimal board size for efficient management and oversight for reduction in modified audit opinion. The theory has been reinforced through regular oversight and identification of areas that are likely to increase risk to investors' obtaining quality information. Stakeholder theory is enhanced in the study where independent board members represent the interest of different stakeholders to reduce chances of modified audit opinion. Institutional theory has been advanced in the study by demonstrating the importance of incorporating a moderate number of independent members to improve efficiency in monitoring and hence lower modified audit opinion.

### **5.3.2. Policy Recommendations**

Board members are important in providing leadership and protecting the interests of shareholders and the general stakeholders. The study recommends improvement in legislation to enhance governance of companies listed at Nairobi Securities Exchange. Policies may be recommended to reduce board size for enhanced efficiency, engagement and improved oversight. This will improve financial reporting quality, protect the companies from fraudulent activities as well as the investors and the general public.

### **5.3.4. Practical Recommendations**

The study recommends budget allocation for improved training of board members to equip the board with emerging trends in financial and accounting matters for enhanced quality in financial reporting. Training will also enhance board members with critical knowledge of best practices in line with national and global standards thereby reduce modified audit opinion.

Board independence contributes significantly in the reduction of modified audit opinion. The more there are independent members, the lower it becomes for modified audit opinion. Companies should enhance independent board members to ensure a balanced opinion with rational decision making for purposes of lowering modified audit opinion.

There are companies that perform well with small board size while others may need larger board size to meet their objectives. Additionally, the diversity that comes with board size enhances the creativity of the board which is critical in identifying issues of concern to modified audit opinion. The study makes recommendation on the need to adopt an optimal board size according to company size and activities to lower modified audit opinion.

Frequency of board meetings is crucial in tabling companies' needs, identifying trends in the business environment, overseeing implementation of the activities and providing oversight role in the company's financial management. The findings demonstrated that the more the meetings the higher the chances of decreasing modified audit opinion. The study recommends the need for enhanced board meetings in line with activities of the company to enable the board detect any issue that may lead to modified audit opinion.

#### **5.4.4 Recommendation for Further Studies**

The researcher investigated board characteristics on modified audit opinion of listed companies in the Nairobi Securities Exchange focussing on 2015-2024. However, this limited the inclusion of 23 companies who did not have all the data for the entire period. Other studies may need to consider working with a five-year period data to increase the number of participating companies above 40 to establish any difference in the study variable relationship. The current study worked with explanatory and the response variables. Future research may consider incorporating

moderating or mediating variables. The study focused on different companies emanating from different industries. However, the balancing of professional qualification was different according to the sector or needs of a particular industry. Future study may consider targeting a particular sector with common characteristics to establish any difference in the outcome. The study used fixed effect panel data analysis. Future study may consider using different techniques to make comparison on the best model in predicting modified audit opinion.

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**APPENDIX I: DATA COLLECTION SHEET**

<b>Year</b>	<b>Firm name</b>	<b>“1”or 0</b>	<b>No. of BS independent directors</b>	<b>No. of BS with finance and accounting qualification</b>	<b>No. of members on board</b>	<b>No. of meetings held</b>
2015-2024						
2015-2024						
2015-2024						
2015-2024						
2015-2024						
2015-2024						
2015-2024						
2015-2024						
2015-2024						
2015-2024						
2015-2024						
2015-2024						

**APPENDIX II: LISTED COMPANIES AT NAIROBI SECURITIES EXCHANGE**

<b>No</b>	<b>Companies</b>
1	Eaagads Ltd
2	Kakuzi
3	Rea Vipingo
4	Sasini
5	Williamson Tea
6	Car and General Kenya Ltd
7	Absa Bank
8	Bank of Kigali
9	I&M Holdings
10	Diamond Trust Bank
11	Standard Chartered Bank
12	Equity Group Holdings
13	HF Group Ltd
14	Sameer Africa Plc
15	Nation Media Group
16	Standard Group Ltd
17	Scangroup Ltd
18	Longhorn Publishers
19	Nairobi Business Ventures
20	Bamburi Cement Plc
21	Crown Paints Kenya
22	East africa Portland Cement
23	Total Kenya Ltd
24	KenGen Ltd
25	Umeme Ltd
26	Sanlam Kenya Plc
27	Kenya Re-Insurance Corporation
28	Liberty Kenya Holdings Ltd.
29	Britam Holdings Ltd.
30	Centum Investment Co. Ltd.
31	Trans-Century Ltd.
32	Home Afrika Ltd.
33	Nairobi Securities Exchange Ltd.
34	BOC Kenya Ltd.
35	British American Tobacco Kenya Ltd.
36	Carbacid Investments Ltd.
37	East African Breweries Ltd.
38	Unga Group Ltd.

39	Flame Tree
40	Safaricom Plc

### APPENDIX III: DATA SNAPSHOT

#### FE

Coefficients:					
	Estimate	Std. Error	t-value	Pr(> t )	
Qual	-1.4001e-16	1.1914e-16	-1.1752e+00	0.2407073	
Inde	-2.0283e-16	1.0686e-16	-1.8981e+00	0.0585122	.
Size	5.8383e-16	1.7007e-16	3.4330e+00	0.0006692	***
Meet	-1.0826e-15	1.7367e-16	-6.2339e+00	1.320e-09	***
factor(Year)2016	-1.0000e+00	1.2129e-16	-8.2448e+15	< 2.2e-16	***
factor(Year)2017	1.8710e-17	1.2167e-16	1.5380e-01	0.8778680	
factor(Year)2018	-1.0000e+00	1.2191e-16	-8.2027e+15	< 2.2e-16	***
factor(Year)2019	-2.1062e-16	1.2257e-16	-1.7183e+00	0.0866277	.
factor(Year)2020	-1.0000e+00	1.2211e-16	-8.1894e+15	< 2.2e-16	***
factor(Year)2021	5.1401e-16	1.2204e-16	4.2119e+00	3.232e-05	***
factor(Year)2022	-1.0000e+00	1.2211e-16	-8.1893e+15	< 2.2e-16	***
factor(Year)2023	4.3338e-16	1.2251e-16	3.5374e+00	0.0004590	***
factor(Year)2024	-1.0000e+00	1.2240e-16	-8.1696e+15	< 2.2e-16	***

#### RE

Coefficients:					
	Estimate	Std. Error	z-value	Pr(> z )	
(Intercept)	1.0000e+00	9.8020e-16	1.0202e+15	< 2.2e-16	***
Qual	-4.3089e-16	1.5013e-16	-2.8702e+00	0.0041024	**
Inde	4.6225e-17	1.3469e-16	3.4320e-01	0.7314478	
Size	-2.8809e-17	2.1430e-16	-1.3440e-01	0.8930607	
Meet	-1.4559e-16	2.1877e-16	-6.6550e-01	0.5057381	
factor(Year)2016	-1.0000e+00	1.5312e-16	-6.5307e+15	< 2.2e-16	***
factor(Year)2017	3.5549e-16	1.5359e-16	2.3145e+00	0.0206421	*
factor(Year)2018	-1.0000e+00	1.5390e-16	-6.4976e+15	< 2.2e-16	***
factor(Year)2019	-5.7441e-17	1.5474e-16	-3.7120e-01	0.7104727	
factor(Year)2020	-1.0000e+00	1.5415e-16	-6.4870e+15	< 2.2e-16	***
factor(Year)2021	-1.5816e-16	1.5406e-16	-1.0266e+00	0.3046285	
factor(Year)2022	-1.0000e+00	1.5415e-16	-6.4871e+15	< 2.2e-16	***
factor(Year)2023	5.2003e-16	1.5466e-16	3.3624e+00	0.0007726	***
factor(Year)2024	-1.0000e+00	1.5453e-16	-6.4714e+15	< 2.2e-16	***
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Signif. codes:	0 '***'	0.001 '**'	0.01 '*'	0.05 '.'	0.1 ' ' 1