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Effectiveness of Audit Committees in the Public Sector: A Case of Parastatals in Kenya

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Abstract
The paper study the relationship between the characteristics of audit committees and its effectiveness in reducing the number of financial statement restatements for State Corporations in Kenya. It used the following six characteristics of audit committees: independence of directors, committee size, meeting frequency, financial expertise, tenure and multiple directorships for 177 State corporations. The finance theory of agency was used as the theoretical underpinning for the study. The aim was to provide answers to two main research objectives by the use of cross sectional secondary data collected from the audited financial statements of the 177 State corporations in Kenya. The objectives were, first, to find out if the audit committees meet the legislative requirements on audit committee characteristics, and the second was to determine the effect of audit committees' characteristics on their effectiveness. The sampling frame was state corporations in Kenya consisting of 177 firm year observations for the year 2012 selected using purposive sampling. The logistic regression model was used to test the effect of the characteristics of the committee on its effectiveness. The findings indicate that the most important and influential characteristics of audit committees is multiple directorships and audit committee tenure as they are statistically significant in reducing the number of financial statement restatements. A key recommendation of this study is that the Kenya government should enact legislation that governs audit committees and impose stiff penalties on audit committees that are not effective.
Keywords: Audit Committees, Audit Committee effectiveness, Kenya.

1.0 : Introduction

The Treasury Circular No 6 of 2005 in the case of all public sector institutions, regulates audit committees of State Corporations in Kenya. The Circular dated 4 October 2005, that directs the operationalization of public sector audit committees. In relation to setting up of audit committees section five of the Public Finance Management Act of the year 2012 requires all public entities to set up effective audit committees in all national government public entities (ministries, departments, State Corporations, and local authorities). The guidelines indicate the composition and the operation of the committees. It maintains that if these committees function effectively they will contribute to the enhancement of oversight, governance, and accountability in the public service. The audit committees of State Corporations in Kenya therefore derive their authority from this circular and public finance management Act of the year 2012.

An audit committee is an appointed body that is meant to aid the management of an entity in the role of over sighting the checks and internal controls of an entity including the monitoring of the internal audit function. This definition is in line with the requirements of the agency theory of finance which proposes that for the effective monitoring of the agents (management) by the principals who are the providers of resources to the public entities, an effective audit committee that is well constituted as per legislation is important.

Under the agency relationship, there is always the disagreement that arises because of the different approaches between the agents and the principals in terms of management of the entity. Eichenseher and Shields (1985) view audit committees as monitoring tools that reduce information asymmetry between the management of an entity and the stakeholders of the entity. Effective audit committees are beneficial to various stakeholders such as the auditors both internal and external and the agents that are appointed to run the entities. Psaros and Seamer (2004) in their study on audit committees and accountability in the South African public sector point out that a number of benefits result from an effective audit committee. They indicate that when the audit committees carry out their functions effectively the quality of financial reporting is maintained.

The audit committee has been extensively used in organizations globally to monitor the financial reporting process and corporate governance. They have been in existence for decades, but there are criticisms regarding their effectiveness as a result of the role of vetting the financial statement integrity of the entity and the monitoring of financial statement fraud. The criticisms mainly center on the recurrence of financial scandals even where such committees exist. In Kenya, effective audit committees in the public sector are important especially during this moment when countless financial scandals have plagued the public institutions**.** They include Anglo Leasing scandal of 2005, Grand Regency scandal of 2008, The Housing Finance Scandal, The Triton oil scandal of 2009 among others. On the international scene these committees have been critiqued due to their failure to pinpoint and put an end to the fraudulent activities within the Enron Corporation following its downfall.

While investigating and analyzing the effective working of audit committees at the largest listed companies in South Africa, Brewer (2001) reports that these committees should be made effective in their formation and operation and that they should not just be constituted for compliance purposes only as required by various pieces of legislation. Therefore having an audit committee and realizing the benefits that go with it are not always synonymous. The study of the Audit Committees is important at this time in order to evaluate the effectiveness of these committees in relation to the occurrence of these financial frauds. In light of the above-mentioned, this study was motivated to find out if audit committees of state corporations in Kenya that are established with the specific characteristics are effective in the context of ensuring that the financial statements of state corporations are prepared to reflect a true and fair view of the financial position within a reporting financial year.

In Kenya State corporation audit committees are required to have a number of characteristics for effective operation in their roles of vetting the integrity of financial statements. The characteristics that were used in the study include: director independence which is represented by having the proportion of independent non-executive directors in the board, tenure of the directors, size of the committee, financial expertise for the audit committee, frequency of committee meetings and multiple directorships in the board; as proxy for evaluating the effectiveness of these committees in Kenya. The Kenya government decided to enforce the establishment and strengthen audit committees in all ministries, departments, State Corporations, and local authorities through the release of Treasury Circular of 4 October 2005 and the public finance management Act for 2012.The committees are expected to carry in depth interrogation of the existing public entity internal controls as well as the operation of the audit function of the public service.

1.1 Statement of the Problem

Audit committees are recognized as the best practice in vetting the integrity of financial statements of public entities around the world. The 2001 Enron Corporation's scandal in the United States was a wakeup call for governments globally. This led to steady moves which were aimed at ensuring the integrity of financial statements in order to ensure that the interests and activities of the principals are protected from any activities of management that are not intended for the benefit of the principal. This is because the principals rely on the public entities financial statements for decision making in the provision of resources. As a measure of ensuring that the committees of audit are effective in their monitoring function, the United States government introduced the Sarbanes-Oxley Act in 2002.The implementation of the Act is compulsory and it is one of the outcomes of this consistent move towards accurate and quality financial reporting (Whittington, 1993).

Various stakeholders are interested in the prudent management of the public sector entities. This is because the stakeholders contribute to the public sector in different ways. Goddard and Masters (2000) report that audit committees are an important establishment in the public sector. However, few studies have been carried out on their effectiveness. The findings of Kalbers and Fogarty (1993) indicate that the subject of audit committee effectiveness in the monitoring and oversight role remains insufficiently understood. Hussein (2003) scrutinized the effect of audit committees on major announcements and other characteristics of companies listed at the Nairobi Stock Exchange (NSE). However, he did not conclusively address the question of whether audit committees are effective in their roles or which characteristics influence audit committee effectiveness. In the Kenyan public sector because of the recognition accorded to accurate and quality financial reporting by several interested parties (principals under the agency theory), the establishment of effective audit committees has been included in audit committee legislation through the issue of Treasury Circular of 4 October 2005 and the Public finance management Act of 2012 requiring all the public sector entities, to establish audit committees. This legislation requires the public sector entities to establish effective audit committees with specific characteristics.

Despite the legislation that has been enacted to establish effective audit committees with the required characteristics in the public sector in Kenya, there have been reported cases of failure of several state corporations among them the National Social Security Fund (NSSF), the Kenya Meat Commission (KMC), Kenya Cooperative Creameries (KCC) among others, due to fraudulent financial reporting. Following these events it is important to find out if these committees are effective in the public sector in Kenya following these various pieces of legislation on audit committees in Kenya. Therefore, this study needed to address the gap in literature concerning audit committee characteristics and their influence on audit committee effectiveness in state corporations in Kenya. The paper endeavours to seek answers on whether the public sector committees of audit are effective in their roles of vetting the integrity of financial statements of State Corporations in Kenya.

1.2 Research Objectives

This study examined the effectiveness of audit committees within national public entities, with a specific focus on State Corporations.

The study was meant to meet the following specific objectives:

1. To find out if the audit committees meet the legislative requirements on audit committee characteristics.
2. To determine the effect of audit committees' characteristics on their effectiveness.

2.0 : Methodology

This section discusses the method and procedures employed in carrying out the study. It has particular focus on the study target population, sampling method, data, and model specification.

2.1 Study Target Population

The unit of analysis for this study was audit committees of Kenya State Corporations while the population of study comprised of all the Kenya state corporations that share common constitutive instruments of the state corporation Act chapter 446. Focusing on the year 2012, there were 182 State Corporations incorporated by similar constitutive instrument of the state corporations Act chapter 446. They are divided into seven categories namely: financial, commercial, regulatory, service corporations, research, training and regional development State Corporations. All State Corporations in Kenya are required to follow the existing government regulations and others that are issued to guide the operations of these committees.

2.2 Sample Selection and Sampling Method

The sample for the study is 177 firm-year observations from 182 State Corporations for the year 2012. The period of 2012 was used for this study to coincide with the Public Financial Management Act of 2012 which issues guidelines on financial integrity and quality of financial statements issued by the public sector in Kenya. The study focused on State Corporations in Kenya public sector because they have a similar way of operation and are guided by similar legislation and the constitutive instruments (The State Corporations Act cap 446). From the total population of 182 State corporations in Kenya, 5 State corporations were dropped from the list because they did not meet the selection criteria for this study.

The criterion adopted was that all the state corporations selected for the study were expected to have issued the annual audited financial statements at the time of the study. The dropped state corporations from the population had issued unaudited interim financial statements at the time of the study. The dropped state corporations had been in business for only six months during the year of study. This reduced the sample to 177 State corporations that are used for this study. Therefore the sample for this study represents 97 % of the population and purposive sampling was used because the State Corporations in Kenya have similar characteristics in terms of their operation and are governed by similar constitutive instruments as required by the State Corporations Act cap 446.

2.3 Data

This study collected and used secondary data in form of audited annual financial reports of the State Corporations in Kenya online from the website of the Office of the Auditor General (OAG) for the year 2012. The State Corporations' annual financial reports were examined for compliance with legislative requirements in order to meet objective one that was to determine if the committees meet the legislative requirements on audit committee characteristics. The following characteristics that are required by legislation were collected from the financial reports. They include: size of the committee, financial expertise, meetings frequency, multiple directorships independence which was determined whether the director is an independent non-executive member, multiple directorships and tenure were collected. Audit committee members' biographical information was examined to determine whether a director possessed financial expertise in accounting and are members of ICPAK and the audit committee tenure variable measured how long the particular director served on the state corporation's audit committee. The annual financial reports were also examined to determine if there was any reported restatement.

2.4 Model Specification

The logistic regression model as used in Abbott et al. (2003) was adopted in this study to test the effect of the characteristics of the committee on audit committee effectiveness in reducing the number of financial statement restatements. Restatement is a dummy coded as 1 for a restatement and zero for no restatement. The model used for analysis in this study is given as follows;

$$\ln(ACE) = \beta_0 + \beta_1 ACIND + \beta_2 ACMD + \beta_3 ACFXP + \beta_4 ACFMT + \beta_5 ACSIZE + \beta_6 ACTNR + \beta_7 SIZE + \beta_8 INDS + \varepsilon$$

Where;
ACE : Audit committee effectiveness; reduced number of financial statement restatements.
ACIND : Independence of the audit committee; the proportion of independent directors.
ACMD : Audit committee multiple directorships; the proportion of directors holding more than one seat.
ACFXP : Audit committee financial expertise; the proportion of directors with financial expertise in accounting and are ICPAK members.
ACFMT : Audit committee frequency of meetings; the actual number of committee meetings held in a financial year.
ACSIZE : Audit committee size; the actual number of directors in the committee.
ACTNR : Audit committee tenure; the length of period director serves in the committee.
SIZE : The total annual budgetary allocation of a State corporation in Kenya shillings millions; represented by the absolute figures in Kenya shillings.
INDS : The industry type of State Corporation, classified by the coding that is used by the International Standard Industrial Classification (ISIC).
ε : Error term

3.0 : Results

The findings of the study on the effectiveness of audit committees in the public sector in Kenya are presented in this section. The dependent variable of audit committee effectiveness was regressed over eight independent variables (six audit committee characteristics) and two control variables(Size of the State Corporation and Industry Type of the state corporation). This was done in order to meet the two research objectives, first to find out if the audit committees meet the legislative requirements on audit committee characteristics and secondly to determine the effect of audit committee' characteristics on their effectiveness.

3.1 Descriptive Statistics

The results from Table 1 suggest that on average 49.3% of the directors in state corporations are independent of Management (ACIND) with 59% on average having multiple directorship (ACMD). Again, the results show that on average 32.7% of the directors on the audit committee have financial expertise (ACFXP).

The average times the audit committee hold meetings is six times a year with a minimum of three meetings and maximum of nine meetings (ACFMT). Considering the size of audit committee (ACSIZE), the results in Table 1 suggest that the average audit committee size is about seven directors with a minimum of five and maximum of nine directors. The average tenure of audit committee (ACTNR) is about three years. The minimum tenure is one year and the maximum is five years. Noteworthy, the results indicate that 71% of the state corporations had restated their financial statements.

The descriptive findings suggest that the state corporation audit committees, on average, meet the legislative requirements on audit committee characteristics particularly on audit committee frequency of meetings, audit committee size and tenure of the audit committee.

3.2 Correlation Analysis

Table 2 provide correlation coefficient between the variables of the study. The results suggest that Audit Committee Independence (ACIND) has a weak positive relationship with other variables apart from Audit Committee Size (ACSIZE), which is negative and significant at 0.01 level. Noteworthy, Audit Committee Size (ACSIZE) has negative weak relationship with other variables which are significant (apart from ACTNR which is weak positive and insignificant). These findings, therefore, suggest that ACIND and ACSIZE are the most important audit committee characteristics.

In order to test for multicollearity, the study adopted the threshold of 0.8 from prior studies. Hogan et al (2008) suggest 0.8 as the beginning of the correlation level at which multicollinearity negatively affect the regression analysis. The correlation matrix in Table 2 shows that the maximum absolute value among the correlation coefficients is -0.393 between ACSIZE and ACIND. This is below the threshold of 0.8 proposed by Hogan et al (2008) for evidence of severe multicollinearity. Having shown that there exist no severe multicollinearity from the correlation analysis, next is to run a regression analysis to be able to estimate the effect of audit committee characteristics on audit committee effectiveness.

3.3 Regression Analysis

Table 3 contains the results of the regression analysis that examines the effect of audit committee characteristics on audit committee effectiveness in reducing the number of financial statement restatements. The variable that measures audit committee independence (ACIND) showed a significant negative relationship between audit committee independence and committee effectiveness with 0.211 odds ratio. These results are consistent with those of Plumlee & Yohn (2010) who do not find any association between reduced financial statement restatement and the existence of majority independent directors. They reported that only the presence of an audit committee is associated with lower financial statement restatements but not necessarily independent audit committee. These finding could be attributed to the opinion that the audit committee members could be perceived as independent of the State Corporation but this independence is eroded as they become affiliated with the management, and as a result of the resource dependence theory they rely more and more on the financial rewards from the State Corporation hence reducing audit committee effectiveness.

The variable that measures multiple directorships (ACMD) showed a significant positive relationship with audit committee effectiveness. The 0.0989 odds ratio for ACMD indicates that a one unit change in the proportion of audit committee multiple directorships increases the odds of audit committee effectiveness in reducing financial statement restatements by a factor of 0.0989. Thus the likelihood of the audit committee being effective given multiple directorships is 9.89 %. These results are consistent with those of Zheng & Cullinan (2010) who found that the number of financial statement restatements decreases as the proportion of multiple directorships increases in the audit committee. The results suggest that multiple directorship increases the audit committee effectiveness as members with multiple directorships bring varying expertise and skills to the audit committee which in turn aids the committee in vetting the integrity of financial statements hence reducing the number of financial statement restatements hence increasing the audit committee effectiveness.

Looking at audit committee financial expertise (ACFXP), the results showed a significant negative relationship between audit committee financial expertise and committee effectiveness. These results are consistent with those in the McMullen (1996) study which showed that the number of financial statement restatements increases as the proportion of financial experts increases in the audit committee. These results could be explained by the argument that audit committee members with financial expertise may actually be less effective than members with other qualifications, such as hands-on management experience. Additionally, financial experts provide different but matching viewpoints McMullen (1996). Hence, an audit committee composed of a high proportion of financial experts may be less effective at reducing the number of financial statement restatements than a more balanced board.

The audit committee frequency of meetings (ACFMT) variable showed a non-significant negative relationship between audit committee frequency of meetings and committee effectiveness. The 0.606 odds ratio for ACFMT indicates that a one point increase in the audit committee frequency of meetings increases the odds of audit committee effectiveness in reducing the number of financial statement restatements by a factor of 0.606. These results are consistent with those in the Dhaliwal et al. (2010) study which find no evidence of a positive influence on audit committee effectiveness in reducing the number of financial statement restatements by the frequency of meetings. This could be attributed to the institutional theory that focuses on systems and processes. This suggests that an entity’s activities and processes are influenced by particular requirements that are aimed at increasing effectiveness. This study therefore suggests that the frequency of meetings is influenced by the legislative requirements that the audit committee shall meet at least four times in a year with no significant effect on the audit committee effectiveness.

Regarding audit committee size (ACSIZE), the results showed a non-significant positive relationship with committee effectiveness. These results are consistent with those in the Beasley (1996) study which suggests that the number of financial statement restatements decreases as the audit committee size increases. The plausible explanation for these results is that as the audit committee size increases then the audit committee gets more combination of skills from the increased committee on vetting the quality of financial statements. They are therefore able to monitor financial statement preparation and hence reduce the number of financial statement restatements.

Concerning audit committee tenure (ACTNR), a significant positive relationship between audit committee tenure and committee effectiveness was obtained from the findings. These results are consistent with those in the Beasley (1996) who found that the number of financial statement restatements decreases as the tenure of the audit committee increases. The plausible explanation for these results is that as the audit committee tenure increases then, the audit committee becomes more aware of the State Corporation's environment and acquires more skills on the quality of financial statements. They are therefore able to monitor financial statement preparation and hence reduce the financial statement restatements hence increasing the audit committee effectiveness.

The regression analysis therefore suggest that, multiple directorships and audit committee tenure are the audit committee characteristics which influence audit committee effectiveness in reducing financial statement restatements. On the other hand, perceived audit committee independence and increased audit committee financial expertise increase audit committee ineffectiveness. The results, therefore, suggest that the audit committees should be truly independent from state corporations with variety of skills (not only financial expertise) to be effective.

Regarding the control variable, the results do not generally support the predictions of the prior literature. In this study, results for control variables lack significance. The results in Table 3 indicate that there is no significant association between the two control variables of size and industry type and audit committee effectiveness in reducing the number of financial statement restatements.

3.3.1 Overall Model Evaluation

From the regression results relative to previous studies, the model fairly explained audit Committee effectiveness concept measured by the reduced number of financial statement restatements. The explanatory power of the model is fairly better than previous studies on audit committee effectiveness. For instance, Collier and Gregory (1996) in their research reported a 13% (R^2) correlation compared to the model in this study that generated a Nagelkerke R^2 of 14.1% for financial statement restatement (see Table 4). This means that for financial statement fraud the variables of the study can only explain 14.1% of audit committee effectiveness with 86% being explained by extraneous variables.

3.3.2 Goodness of Fit Test

In order to test the null hypothesis that there is a linear relationship between the independent variables and the log odds of the dependent variable the Hosmer and Lemeshow test was used to compare the observe and expected frequencies in the model, the Chi-square was computed. From the results in Table 5 of the Chi-square of the Hosmer and Lemeshow tests, a non-significant chi-square of 0.198 for financial statement restatement indicates that the data for the 177 state corporations used in this study fit the model well.

3.3.3 Assessment of Predicted Probabilities

The decision rule for assessment of predicted probabilities adopted by this research is in the following form: if the probability of the event (financial statement restatement) is greater than or equal to 0.5 (50%), the researcher predicted that the event took place. The study classified the subject to mean audit committee effectiveness (ACE) category if the estimated probability was 0.5 (50%) or less and classified the subject otherwise if the estimated probability of the event (financial statement restatement) was 0.5 (50%) and above. The classification in Table 6 show that the model correctly predicted 75.1% of financial statement restatement. This is the probability that financial statement restatement did occur. Overall, the predictions of the study on financial statement restatement were correct 133 times out of the expected177 (75.1%).

4.0 : Summary, Conclusion and Recommendations

The public sector in Kenya was the focus of the study with a particular emphasis on the State corporations in Kenya, where the influence of the characteristics of the committees of audit on their effectiveness were assessed. To assess perceived effectiveness of audit committees, secondary data from the annual audited reports of State Corporations in Kenya were used, whereby the reports of State Corporations with financial restatements and those with reported financial fraud were taken from the selected sample of State Corporations.

The study provided two research objectives at the beginning of the study. Objective one was to find out if the audit committees meet the legislative requirements on audit committee characteristics while objective two was to determine the effect of audit committees' characteristics on their effectiveness.

The data requirements were divided into several categories: Financial statement restatement disclosures, and non-financial disclosures which included: the proportion of independent directors, proportion of multiple directorships, proportion of directors having financial expertise, meeting frequency, committee size and director tenure, the, annual financial budgetary allocation in Kenya shillings and state corporation industry type. However, to meet the requirements of objective two which sought to determine the effect of audit committees' characteristics on their effectiveness and to assess the significance of the relationship between the variables, Pearson Correlation and regression analysis were used. The proxy variable used to measure audit committee effectiveness (dependent variable) in this study is financial statement restatement which was regressed against the independent variables using logistic regression.

It was anticipated that the study, will invoke important ideas for public institutions in Kenya and result in an improved comprehension of the concept of audit committee effectiveness and come up with the various ways of improving its effectiveness. Additionally, the study anticipated that the findings will help improve the understanding of the relationships between committee characteristics and its effectiveness. Lastly, it was anticipated that the results of the study would make an addition to the existing literature on committee effectiveness the public sector while providing a comparison to similar studies conducted in various developed countries.

4.1 Research Findings

The study demonstrates that, on average, the audit committees of state corporations in Kenya have complied with legislation regarding the requirement that they be formed with particular characteristics. From the descriptive results in Table 1 it is noted that on average 49.3% of the directors in the audit committees are independent. On the variable of multiple directorships, on average, 59% of the directors in the audit committees hold more than one seat in other public entities. On average 32.7% of the directors have financial expertise. The committee meets 6 times in a year with an average of seven directors as the committee. The number of years a director serves in the audit committee is on average of 3 years, while lastly the average State Corporations size in terms of annual budgetary allocation in Kenya shillings is Kshs 717,500.

The results however indicate, that more than eight years (2005-2012) after implementation of State corporation audit committees, 71% (126) of the committees failed to reduce the number of financial statement restatements according to the descriptive results of this study. Overall, the results indicate that all the committees are ineffective because the number of financial statement restatements is above the threshold of 50% used in this study to measure effectiveness.

Regarding the effect of audit committee characteristics on audit committee effectiveness, the regression findings in Table 3 show that the characteristic of multiple directorships and audit committee tenure are the key characteristics in audit committee effectiveness in the role of vetting the integrity of financial statements. These results are consistent with those in the Zheng & Cullinan (2010) study which found that the integrity of financial statements increases as the proportion of multiple directorships increases in the audit committee. On the other hand, audit committee independence and financial expertise of the audit committee increases the audit committee ineffectiveness. These results are consistent with those in the McMullen (1996) study that showed that the number of financial statement restatements increases as the proportion of financial experts increases in the audit committee.

4.2 Conclusion and Recommendations

The findings resulted in a more improved understanding of the concept of audit committee effectiveness in the public sector and suggested various ways of improving the effectiveness, in their roles of vetting the integrity of financial statements of State Corporations in the public sector.

Additionally, the study resulted in an improved understanding of the relationships between the audit committee characteristics and audit committee effectiveness. Lastly, an addition to existing literature on audit committee effectiveness and comparison to similar past studies conducted in various developed countries on audit committee effectiveness was achieved.

Following the findings from this study, the study offers the following key recommendations:

1. The Kenya government should enact legislation that governs audit committees and impose stiff penalties on audit committees that are not effective. This will help improve the effectiveness of audit committees with regard to vetting the integrity of financial statements.
2. An effective legal framework should be put in place to set the mandatory number of multiple directorships that an audit committee member should hold in a public entity in order to limit the number of seats each director should hold and refocus on making sure the director optimally serves the committees he or she seats in.
3. There is an urgent need to create an effective legal framework that requires the audit committee to have a variety of trained skills in different field which include management as well as financial expertise to enhance audit committee effectiveness.

4.3 Suggestions for further research

As with most studies, this research is not perfect and has various limitations, therefore, findings from the study should be used with caution to the extent of the following limitations. Firstly, the public sector in Kenya is made up a number of ministries, boards, commissions, departments, councils, local authorities and State Corporations. All the public sector institutions in Kenya are required to establish functional audit committees hence the public sector in Kenya is wide. Therefore, this study covered only the State Corporations in Kenya. Results from the study will therefore not be generalized on the whole public sector in Kenya. Secondly, the choice of variables that would be used to rightly measure the effectiveness of audit committees in the public sector was a challenge. Thirdly, this study is essentially a cross sectional study that examines the audit committee phenomenon at a particular point in time for the year 2012. This may not give a complete picture of the phenomenon studied. Lastly, logistic constraints cannot be overemphasized, as they limited the intensity of the spread or area of coverage of the study. Moreover, the study started when the use of audit committees in the public sector in Kenya had just taken off hence, it is a new phenomenon.

However, a variety of efforts were used to mitigate these limitations. First, the criterion for measuring the effectiveness of audit committee performance were compared with principles and guidelines that guide the operationalization of effective public sector audit committees such as the Kenya Treasury Circular of 4 October 2005. Secondly, to make it valuable, the study was focused only on audit committee function of scrutinizing of financial statement integrity of the Kenyan State Corporations. And lastly to proxy for unobservable phenomena like independence a criteria was given by defining independence for this study as directors that are neither current nor former employees nor have contractual or through immediate family member any relationship with the state corporation.

Following these limitations, as suggestions for further studies, it will be valuable to study the relationship between the appointing mechanism and audit committee effectiveness in the public sector. This will help in understanding how the appointing mechanism influences audit committee effectiveness. In addition, a study that investigates the relevance of legislation on audit committee characteristics and committee operation could be important to the body of knowledge. This will help in the understanding on how the various pieces of legislation influence audit committee effectiveness.

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Table 1. Descriptive Statistics

Variable Description	**N**	**Minimum**	**Maximum**	**Mean**	**Std**
ACIND	177	.1	1.0	.493	.2075
ACMD	177	.1	1.1	.590	.2646
ACFXP	177	.1	.6	.327	.1285
ACFMT	177	3	9	6.03	1.500
ACSIZE	177	5	9	7.13	1.103
ACTNR	177	1	5	2.87	1.108
SIZE(Kshs)	177	.00	1.00	.7175	.45149
INDS	177	1	7	4.18	2.231
RESTATEMENT	177	0	1	.71	.454
FRAUD	177	0	1	.52	.501
Valid N (listwise)	177				

Table 2. Correlations Analysis

Correlation Matrix						
Variables	ACIND	ACMD	ACFXP	ACFMT	ACSIZE	ACTNR
ACIND	1.000	.158 .063*	.243 .063*	.243 .216	-.393 .000***	.148 .083*
ACMD		1.000	.071 .408	.074 .387	-.154 .070*	-.042 .625
ACFXP			1.000	.036 .677	-.294 .000***	.048 .578
ACFMT				1.000	-.202 .017**	-.045 .600
ACSIZE					1.000	-.124 .147
ACTNR						1.000

Notes: *** significant 0.01 level; ** significant at 0.05 level; * significant at 0.10 level.

Where;
ACIND : Audit committee independence
ACMD : Audit committee multiple directorships
ACFXP : Audit committee financial expertise
ACFMT : Audit committee frequency of meetings
ACSIZE : Audit committee size
ACTNR : Audit committee tenure

Table 3. Logistic Regression for Financial Statement Restatements

	B	**S.E**	**Wald**	**Df**	**Sig.**	**Exp(B)**
Step 1[a] ACIND	-1.556	.721	4.659	1	.031**	.211
ACMD	9.200	4.810	3.658	1	.056*	0.0989
ACFXP	-17.600	6.201	8.055	1	.005**	.000
ACFMT	-.500	.557	.806	1	.369	.606
ACSIZE	.015	.167	.008	1	.930	1.015
ACTNR	1.251	.627	3.982	1	.046**	3.493
SIZE (Kshs)	-.429	0679	.398	1	.528	.651
INDS	-.080	.081	.967	1	.325	.923
Constant	2.195	2.039	1.159	1	.282	8.979

*** Significant at 0.01 level; ** significant at 0.05 level; * significant at 0.10 level.

Table 4. Overall Model Evaluation

Financial Statement Restatement			
Step	-2 Log likelihood	Cox & Snell R Square	Nagelkerke R Square
1	194.203[a]	.099	.141

a. Estimation terminated at iteration number 5 because parameter estimates changed by less than .001.

Table5. Goodness of Fit Test

Financial Statement Restatement			
Step	Chi-square	df	Sig.
1	11.061	8	.198

Table 6. Assessment of Predicted Probabilities

Financial Statement Restatement					
			Predicted		
			Financial statement restatement		
	Observed		No Restatement	Restatement	Percentage Correct
Step 1	Financial statement restatement	No Restatement	13	38	25.5
		Restatement	6	120	95.2
	Overall Percentage				75.1

a. The cut value is .500