UNIVERSITY OF NAIROBI

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CORPORATE SCANDALS: AN ANALYSIS OF THE LEGAL FRAMEWORK OF CORPORATE GOVERNANCE IN KENYA

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THESIS SUBMITTED TO THE FACULTY OF LAW IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE CONFERMENT OF MASTERS IN LAW

DECLARATION

I declare that ‘Corporate scandals: An analysis of the legal framework of corporate governance in Kenya’ is my own work and that all the sources that I have used or quoted have been indicated and acknowledged by means of complete references.

SIGNATURE: …………………. DATE: …………….

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SUPERVISOR’S DECLARATION

This project has been submitted for examination with my approval as supervisor.

SIGNATURE………………… DATE: …………….
(SUPERVISOR- DR. JACOB GAKERI)

ABSTRACT

The study has examined the legal framework of corporate governance in Kenya. It has highlighted the corporate scandals that have brought down big companies, in the United Kingdom, Maxwell, Polly Peck, Barrings, in the United States, Enron, WorldCom and Tyco International that led to the above-mentioned countries to come up with corporate governance practices that are appropriate.

Kenya's entities have had a history of poor governance system with about 70% of the scandals attributed to weak corporate governance practices, lack of internal controls, and weaknesses in regulatory and supervisory systems. The study analyses the laws and corporate governance codes of best practice that have been adopted in Kenya and whether they comply with international standards while at the same time addressing Kenya's specificities and reform needs.

Lastly, the study based on the findings of the analysis of the situation in Kenya offers recommendations for reform on the laws governing corporate governance in Kenya and suggest ways of promoting good corporate governance practices.

ACKNOWLEDGEMENTS

This project would not have been possible without the essential and gracious support of several people whom I wish to sincerely acknowledge.

Firstly, I would like to thank my supervisor, Dr. Jacob Gakeri for his guidance through the process and progress of my report.

I would like to appreciate my parents and siblings, my friends and fellow classmates for their encouragement and relentless support.

I am also deeply grateful to Lewis Gitonga for his support and guidance.

Most importantly, I thank the Almighty God for seeing me through.

DEDICATION

I dedicate this thesis to my late father Mr. Zachary Ogongo who inspired me to excel in everything that I do and to my loving and supportive mother Agnes Ogongo.

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CHAPTER ONE

1.0 Introduction

Corporate governance is the procedures and processes according to which an organization is directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among the different participants in the organization – such as the board, managers, shareholders and other stakeholders – and lays down the rules and procedures for decision-making.[1]

Corporate governance is how a company is managed in terms of the institutional systems and protocols meant to ensure accountability and sound ethics. The concept encompasses a variety of issues, including the disclosure of information to shareholders and board members, the remuneration of senior executives, potential conflicts of interest among managers and directors, supervisory structures, etc.

Corporate governance is the system by which companies are directed and controlled. The boards of directors are responsible for the governance of their companies. The shareholder's role in governance is to appoint the directors and the auditors to satisfy themselves that an appropriate governance structure is in place. The responsibilities of the board include setting the company's strategic aims, providing the leadership to put them into effect, supervising the management of the business and reporting to shareholders on their stewardship. The board's actions are subject to laws, regulations and the shareholders in general meeting.[2]

The guidelines on corporate governance [3]on the other hand define corporate governance as the process and structure used to direct and manage business affairs of the company towards enhancing prosperity and corporate accounting with the ultimate objective of realizing shareholders long-term value while taking into account the interest of other stakeholders.

[1] Organization for Economic Co-operation and Development (OECD) (1999, 2004) European Central Bank, 2004, Annual Report: 2004, ECB, Frankfurt,
[2] Report of the Committee on the Financial Aspects of Corporate Governance (1992), paras 2.5 – 2.8
[3]Public Listed Companies in Kenya Guidelines on Corporate Governance Practices , Gazette Notice No. 3362 of 2002, 14th May 2002, Article 1.2

In 2002, the significance of good corporate governance hit world headlines when major corporate failures occurred in the US, such as Enron, WorldCom and Tyco leading to seven of the 12 largest bankruptcies in US history. [4]

The corporate failures were as a result of poor corporate governance practices such as too much power that was vested in directors without checks and balances from other company stakeholders. Directors were executing their duties without any control and the board was unable to restrict them because of the poor corporate governance which empowered a director who is also a Chief Executive Officer to be the chairman of the Board.[5]

Sarbanes Oxley Act in the United States introduced many new requirements in the New York Stock Exchange listing rules after the collapse of Enron and WorldCom.[6] As a result of the corporate scandals and collapses, governments, regulators and boards of corporations have reconsidered fundamental issues of corporate governance.[7]

This study will analyse and evaluate the extent to which the Kenyan legal framework has provided for corporate governance issues.

1.1 Background to the study

Kenya has borrowed heavily from the developed nation's mode of corporate governance. This is evidence by the high resemblance between the two. First it is notable that Kenya has a legislation that governs corporate governance, secondly it has a regulatory authority which is the securities

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[4]B Kerrow 'Poor corporate governance remains our Achilles heel 'Standard Newspaper' 7th March 2010 http://www.standardmedia.co.ke/article/2000005034/poor-corporate-governance-remains-our-achilles-heel

[5] Coyle B Corporate Governance (2003) 8-10

[6] G Scott A Look at the Causes, Impact and Future of the Sarbanes-Oxley Act" Journal of International Business and Law: (2004) Vol. 3: Iss. 1, Article 2. http://scholarlycommons.law.hofstra.edu/cgi/viewcontent.cgi?article=1024&context=jibl accessed on 09/11/2016

[7]Commonwealth Association for Corporate Governance Guidelines, Principles For Corporate Governance In The Commonwealth Towards global competitiveness and economic accountability (1999) http://www.ecseonline.com/PDF/CACG%20Guidelines%20%20Principles%20for%20Corporate%20Governance%20in%20the%20Commonwealth.pdf accessed on 09/11/2016

market and lastly it has a through the centre for corporate governance developed a sample code of best practice developed and adopted in the year 2002.[8]

The legislation governing corporate governance is majorly regulated and embodied in the Companies Act of the year 1962, chapter 486 law of Kenya. Kenya borrowed heavily from the England's Companies act of 1948 since it got its independence in the year 1963.[9] Other legislations regulating corporate governance includes the Penal Code chapter 63 laws of Kenya, Capital Markets Act of 2002 and lastly and the most notable is the Sample code of best practice for corporate governance in Kenya.

Before adopting any foreign laws on corporate governance, Kenya ought to confine foreign influences upon its legal system to those rules of corporate governance which have proved successful in other jurisdictions with similar market conditions and to be flexible enough to dismantle those legal traditions based on inappropriate market models, because if this is not taken serious, the nation will continue to grapple with bad vices in the corporate governance management.[10]

Again, care and concern should be held if the country opts to adopt foreign corporate governance practice. This is because policies may differ from those in Kenya where market conditions are similar and the size and nature of the business transacted in these countries and the people that company law is seeking to protect may have different standards of sophistication and education unlike those of the individual Kenyan citizens.

In fact, the law should be in the forefront in definition to keep pace with the needs and demands of a developing society. The point of law being sensitive with the changes and societal needs was clearly pointed out in the case of ***Nyali Ltd v A.G. of Kenya,*** in which instance Lord Denning

[8] Private Sector Corporate Governance Trust Sample Code Of Best Practice For Corporate Governance In Kenya (2002) http://www.corporategovernance.co.ke/principles/Sample%20Code.htm Accessed on 9th November 2016
[9] K Mugambi Ethics the key to honest trade at bourse 'Nation Newspaper' 23rd September 2009 p.26.
[10] E Njoroge (2009, May 14). Capital FM Kenya. Retrieved November 5, 2009, from setting the record straight: www.capitalfm.co.ke/business/Feature O.C, F., Fredrick, J., & Ferrell, L. (2008). Business Ethics: Ethical decision making and cases. Boston, U.S.A: Houghton Mifflin Company. Ocoth, J. (2009, October). NSE seeks reliable broker system`

stated that, one can take an oak tree from English soil and plant it on Kenyan soil, but one cannot guarantee that it will do equally well as in Kenya as it initially did in England. [11]

Kenya's Company law has not been changed to meet the special nature of their needs hence the recurrence of poor corporate governance practices.

1.2 Statement of the problem

Kenya's entities have had a history of poor governance system with about 70% of the scandals attributed to weak corporate governance practices, lack of internal controls, and weaknesses in regulatory and supervisory systems as well as conflict of interest.[12]

Evidence from developed jurisdictions suggests that effectiveness of codes of corporate governance is largely dependent on the underlying legal and regulatory framework.[13] The poor corporate governance practices in Kenya are as a result of the weak legal system.[14] The CMA guidelines replicated the Combined Code of the United Kingdom without any serious attempt to domesticate the principle.[15]

The Companies Act has been borrowed heavily from the England's Companies Act of 1948.[16] Kenya has also through the centre for corporate governance developed a sample code of best practice developed and adopted in the year 2002. This code of corporate governance has been borrowed from presumably more developed countries without necessarily taking into account the underlying conditions of the market in which this code is to be enforced.

The ineffectiveness of the laws, rules, principles and guidelines of corporate governance in Kenya are attributable to the weakness of the underlying legal framework, unwillingness or inability by

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[11] [1955] ALL ER 646

[12], Gladys Rotich, Sicily Gachoki Influence of Corporate Governance on the Performance of Public Organizations in Kenya (a Case of Kenya Ports Authority) Research Journal of Finance and Accounting www.iiste.orgISSN 2222-1697 (Paper) ISSN 2222-2847 (Online) Vol.4, No.6, 2013

[13] J Gakeri Enhancing Kenya's Securities Markets through Corporate Governance: Challenges and Opportunities International Journal of Humanities and Social Science Vol. 3 No. 6 (2013) pg. 96

[14] L Musikali The laws affecting corporate governance in Kenya: a need for review International Company and Commercial Law Review, Vol. 19, No. 7, (2008) pp 213-227

[15] Gakeri Ibid note 14

[16] K Mugambi Ethics the key to honest trade at bourse, says don. 'Nation Newspaper' September 23, 2009, p. 26.

the Capital Markets Authority to enforce the Guidelines, and the failure of publicly held companies to embrace the corporate culture of accountability.[17]

It is clear from the foregoing that the legal framework of corporate governance in Kenya has a gap which needs to be identified and revised in order to enhance good corporate governance practices. Therefore, this study intends to investigate the gaps on the legal framework of corporate governance in Kenya.

1.3 Justification of the research

Many corporations in Kenya have collapsed due to poor corporate governance. In 1985, Kenya witnessed the collapse of 33 banks which were purely attributed to poor corporate governance practices. Corporate governance failures have also led to dysfunctional boards in well-established corporate governance regimes examples being Enron, a United States company, which collapsed in 2001 and most probably Uchumi chain of supermarkets in Kenya.[18] Also, Cooper Motors Corporation (CMC) board of directors was caught up in a row that threatened to bring down one of the biggest motor dealers in Kenya as its sale franchises and financial institutions are ominous to severe links and relations with the company, may continue to suffice unless Kenyan legislators pick a leaf from the laws and legal frameworks of foreign jurisdictions like the United Kingdom, South Africa, Germany, Japan or Korea.

This research will inform policy makers who will want to come up with the corporate governance laws.

Currently, there is a lot of research that has been done, so far there is no research that has extensively dealt with the problem of the legal framework of corporate governance in Kenya and thus this research is aimed at providing insights and to advance knowledge that has been created in the past on corporate governance.

[17] Moeen Cheema & Sikander Shah, Corporate Governance in Developing Economies: The Role of mutual funds in Corporate Governance in Pakistan, 36 HONG KONG L.J. 341

[18] Eshiwani, "Director Liability in the Wake of Uchumi (Collapse)", Institute of Directors (Kenya), July 14, 2006.

1.4 Objectives of the research

1. To investigate the legal framework on corporate governance in Kenya.
2. To investigate the legal framework of corporate governance in the United States of America, United Kingdom and South Africa
3. To evaluate the rights and obligation that states have in promoting good corporate governance practices.
4. To investigate what needs to be done to curb poor corporate governance.
5. To evaluate the effectiveness of the legal framework on corporate governance.

1.5 Research questions

1. What is the legal framework on corporate governance in Kenya?
2. What is the legal framework of corporate governance in the United States of America, United Kingdom and South Africa?
3. What are the obligations that states have and to what extent has Kenya met those obligations?
4. Is there anything that can be done now to curb poor corporate governance practices?
5. To what extent is the legal framework on corporate governance effective?

1.6 Research methodology

This research will gather information through the use of the Library. This research is aimed at analyzing the legal framework of corporate governance in Kenya as well as a comparative analysis of the legal framework of other jurisdictions notably the USA, UK, and South Africa.

1.7 Limitations of the study

Corporate governance is a social, economic and legal problem. This research will only evaluate the problem from the legal perspective because of academical constraints as well as lack of research materials.

1.8 Scope of the study

Corporate Governance is a major problem for all private and public companies around the world. This study will evaluate corporate governance of public- listed companies as a legal problem and investigate it from the Kenyan perspective.

1.9 Theoretical framework

There are many theoretical perspectives which are used to explain corporate governance. This study will only discuss agency and stewardship theories as they predominantly generate the principles of corporate governance that are discussed in the context of the legal framework for Kenya.

1.9.1 Agency theory

Agency theory is based on the notion that the role of organization is to maximize the wealth of their owners or shareholders. This theory analyzes and resolves problems that occur in the relationship between principals who are the owners or shareholders and their agents or top management.[19] It has been pointed out that separation of control from ownership implies that professional managers manage a firm on behalf of the firm's owners.[20] Conflicts arise when a firm's owners perceive the professional managers not to be managing the firm in the best interests of the owners.

Implementation of appropriate governance structures will safeguard the interests of shareholders as managers will act to maximize returns to shareholders.[21] According to the agency theory, corporate governance minimizes the potential for managers to act in a manner that is contrary to the interests of shareholders. The theory suggests that significant ownership of the firm by its top management secures a positive relationship between corporate governance and the amount of stock owned by the top management.[22]

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[19] Eisenhardt KM 'Building theories from case study research' (1989) Academy of Management Review 532

[20] Eisenhardt KM (1989) 533.

[21] Donaldson L & Davies JH 'Boards and Company Performance-Research Challenges the Conventional Wisdom' (1994) Corporate Governance: An International Review 151.

[22] Mallin CA Handbook on International Corporate Governance: Country Analyses (2006) 116.

The agency theory presents the relationship between directors and shareholders as a contract.[23] This implies that the actions of directors, acting as agents of shareholders, must be checked to ensure that they are in the best interests of the shareholders. The proponents of this theory therefore believe that corporate governance is a response to the typical agency problem between investors and managers.

1.9.2 Stewardship theory

According to the stewardship theory organisations serve a broader social[24] purpose than just maximising the wealth of shareholders. Under this theory the stakeholder can be viewed as 'the end' as well as the 'means to an end.' [25] This refers to stakeholders as an instrument to improve corporate performance and efficiency. Stakeholders are included in governance of the company on the ground that their participation will lead to an effective means to improve efficiency, profitability, competition and economic success. The supporters of this theory believe that for its long term survival, corporations should serve multiple stakeholder interests rather than shareholder interests alone.[26]

The stewardship theory holds that corporations are social entities that affect the welfare of many stakeholders.[27] Successful organizations are judged by their ability to add value for all of their stakeholders. Participation of stakeholders in corporate decision-making can enhance efficiency and reduce conflicts.[28] A firm's board of directors and its Chief Executive Officer, acting as stewards, are more motivated to act in the best interests of the firm rather than for their own selfish

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[23] Stiles P &Taylor B Boards at Work: How Directors view their Roles and Responsibilities (2002) 52.

[24] Clarke T &Clegg S Changing Paradigms: The Transformation of Management Knowledge for the 21st Century (1998) 106-107.
An economy or society in which every citizen is a valued member, everyone contributes and everyone benefits in some way. This includes the process of corporate accountability which is reinforced and legitimized by either financial or material interest in the well-being of the corporation.

[25] Ibid 'The end' view of stake holders value means that everyone in a society has to be involved in the governance of the corporation. The corporation is viewed as a social institution in society.

[26] King III Report (2009) para2.3.

[27] Donaldson L& Davis JH 'Stewardship Theory or Agency Theory: CEO Governance and Shareholder Returns' (1991) Australian Journal of Management 116.

[28] Turnbull S Corporate governance: Its Scope, Concerns and Theories (1997) as cited in Tricker RI (Ed.) History of management thought: Corporate governance (2000) ch 4.

interests.[29] It is submitted that the stewardship theory of corporate governance should be adopted for the continued existence of the company.

1.10 Literature review

The following is a discussion of the various books and articles written by eminent scholars on corporate governance.

According to ***A Calder (2008),*** corporate governance is the system by which business corporations are directed and controlled. This book is of the view that good governance practices vary across different countries and companies and that there is no model of corporate governance that can be applied to all countries and companies hence the need for companies and countries to familiarize with principles and practice of good governance appropriate to them. Though the writer has discussed corporate governance and the good governance practices across different countries, she has not discussed weak legal systems of corporate governance which result in corporate failures.

B Tricker (2012) explores the major aspects of corporate governance, principles and codes of practice and the various theories of corporate governance. This book appreciates corporate governance around the world by adopting an international and comparative perspective, contrasting the corporate governance regimes around the world. However, the author does not recognize that corporate governance practices vary across different countries and the need for countries to develop corporate governance codes that take into account the underlying conditions of the market in which the code is to be enforced.

According to ***C Pierce (2004)*** corporate governance is the rules of the game of a company in its relations with shareholders, its lenders and other stakeholders in the business community and with society at large. Corporate governance has become an issue of international concern. This book has analysed the corporate governance systems of various countries among them USA, UK and India among others. This book doesn't recognize that implementing effective laws is a fundamental requirement for establishing a successful corporate governance system.

[29] Clarke T 'Corporate governance: the State of the Art' (1993) *Managerial Auditing Journal* 5.

J Wairimu (2012) has examined the role of Capital Markets Authority (CMA) as a regulator of Nairobi Securities Exchange (NSE) as well as the role of NSE in ensuring proper compliance to regulator's laws and guidelines. This book has focused on the legislation and enforcement procedure within CMA and NSE and also the role of institutions such as Kenya Association of Stockbrokers and Investment Bank (KASIB), Institute of Certified Public Accountants in Kenya (ICPAK) and Centre for Corporate Governance (CCG) in curbing corporate irregularities in Kenya. The author has not recognized the laws on corporate governance in Kenya and if they are effective for establishing a successful corporate governance system.

According to ***Das (2013)*** corporate governance is now emphasized in most industrially developed countries of the world due to serious high profile corporate failures, fraud and malpractices in some of their renowned corporate houses. This book has highlighted corporate governance systems in various countries of the world among them UK, USA, Germany, Japan and France. This book has not made a distinction between countries with strong and those with weak corporate governance systems. Further, it doesn't recognize that a country in developing its code of best practices should not confine foreign influences upon its legal system to those rules that have proved successful in other jurisdictions with similar market conditions but should base the corporate governance codes on the appropriate market models.

According to ***B Mwanzia (2010),*** developing countries differ from developed countries. Developing counties need to come up with corporate governance practices that are appropriate for their cultural, political and technological conditions. This article has discussed the history of corporate governance as well as the theories that affect corporate governance. This book has failed to discuss the need to have good corporate governance legislation and codes that are adequate for achieving effective corporate governance and reducing the number of corporate failures around the world and in Kenya.

Karugor Gatamah (2002) has highlighted the challenges that are faced by Kenya in promoting good governance. According to this article international principles need to be adapted to suit different needs and to address peculiarities of different economies, sectors and types of organizations. The author does not recognize that adopting these principles of corporate governance may lead to a weak legal system that continues to grapple with bad vices in the corporate governance management.

Jacob Gakeri (2013) argues that the operative principles of corporate governance for listed companies, which are based on the dispersed ownership structure and whose enforcement matrix is "comply or explain", have not been particularly effective. He also argues that corporate scandals are reshaping how corporations are controlled and managed. The author has also looked at the laws, rules and principles of corporate governance highlighting some of the corporate failures and has further argued that the ineffectiveness of principles of corporate governance in Kenya is attributable to the weakness of the underlying legal framework, unwillingness or inability by the Capital Markets Authority to enforce the Guidelines, and the failure of publicly held companies to embrace the corporate culture of accountability. The author has not recognized developed nation's mode of corporate governance and corporate governance best practices around the world.

Lois Musikali (2008) looks at the laws affecting corporate governance in Kenya. This article has argued that Kenya's weak legal system is likely to affect the country's quest for good corporate governance and that implementing effective laws is a fundamental requirement for establishing a successful corporate governance system. The author has not recognized developed nation's mode of corporate governance and corporate governance best practices around the world.

The OECD Principles of Corporate Governance (2004) The OECD Principles of Corporate Governance are an international benchmark for policy makers, investors, corporations and other stakeholders worldwide. They have advanced the corporate governance agenda and provided specific guidance for legislative and regulatory initiatives in both OECD and non OECD countries. The Principles offer non-binding standards and good practices as well as guidance on implementation, which can be adapted to the specific circumstances of individual countries and regions

1.11 Chapter breakdown

1.11.1 Chapter one: Introduction and background

This chapter introduces the work by defining corporate governance, and gives the background to the research problem. Corporate scandals have brought down big companies, in the United Kingdom, Maxwell, Polly Peck, Barrings, affected the City of London and the financial markets during the late 1980s. Other companies include Enron, a United States company which collapsed in 2001 and World com which also collapsed in 2002. In Kenya, Uchumi Supermarket had collapsed as a result of an ambitious expansion programme that led to serious cash flow problems.

These collapses were attributed to weak governance systems, lax oversight by the boards of directors, and too much control vested in a single top executive. This chapter also states the objectives of the research, its justification and the research questions which this research attempts to answer. Existing literature on the research topic are also be reviewed and gaps identified for each item of literature. The chapter also gives a synopsis of chapter breakdown of subsequent chapters.

1.11.2 Chapter two: The legal framework of corporate governance in the USA, UK and South Africa

This chapter will discuss the international corporate governance codes of best practices with emphasis on various countries of the world among them UK, USA and South Africa. This chapter will also look at the serious high profile corporate failures, fraud and malpractices which led to the above-mentioned countries to come up with corporate governance practices that are appropriate.

1:11:3 Chapter three: The legal framework on corporate governance in Kenya

This chapter will look at the laws and corporate governance codes of best practice that have been adopted in Kenya. This chapter will also discuss whether the code of best practices in Kenya complies with international standards while at the same time addressing Kenya's specificities and reform needs.

1:11:4 Chapter four: Conclusion and recommendations

This chapter will give a conclusion, based on review of the legal framework of corporate governance in Kenya and other international countries. It will then give recommendations for reform on the laws governing corporate governance in Kenya and suggest ways of promoting good corporate governance practices.

CHAPTER TWO: THE LEGAL FRAMEWORK OF CORPORATEGOVERNANCE IN THE UNITED STATES OF AMERICA, UNITED KINGDOM AND SOUTH AFRICA

2.1 Introduction

Failure of big corporations without prior signal points to loose and fraudulent practices which ordinarily would have been detected by regulators where good corporate governance practices are operational. Against the backdrop of corporate scandals and fraudulent accounting practices, governments and regulators have vociferously labored to introduce stronger regulation to guard against similar collapses in the future to restore investor confidence in financial markets. Whereas in some countries legislation and codes on corporate governance have been in existence for decades, in others governments are just embarking on the development of such codes.[30]

The governance of corporations can be on a statutory basis, or as a code of principles and practices, or a combination of the two. In the United Kingdom and South Africa, corporate governance is regulated through a self-regulatory code of principles and practices which is based on 'comply or explain.' However, in the United States of America, corporations are governed by the Sarbanes-Oxley Act (SOX) which has legal sanctions for non-compliance.

This chapter will discuss the legal framework of corporate governance of the three countries in comparison to that of Kenya.

2.2 Corporate scandals in United States of America

2.2.1 Enron

This was one of the biggest and financially sound companies in the United States of America. It was perhaps the catalyst for the Sarbanes-Oxley legislation.[31]Located in Houston, Texas, the company became one of the world's largest pulp and paper, gas, electricity, and communications companies before it was declared bankrupt in 2001. The government deregulated the oil and gas

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[30] Stephanie Maier How global is good corporate governance? (2005) http://www.eiris.org/files/research%20publications/howglobalisgoodcorpgov05.pdf accessed on 12th October 2014

[31] Rosemary Peavler The Sarbanes-Oxley Act and the Enron Scandal - Why are they Important? The Sarbanes-Oxley Act and Corporate Fraud http://bizfinance.about.com/od/smallbusinessfinancefaqs/a/sarbanes-oxley-act-and-enron-scandal.htm accessed on 26th August 2014

industry[32] prior to the bankruptcy of Enron in order to promote competition. Several companies including Enron took advantage of the deregulation.[33]

Following deregulation, California experienced a series of rolling blackouts of electricity and significant spikes in the price of electricity. Enron's wholesale earnings quadrupled in one year after deregulation attributable to the increased competition.

Disconcertingly, Enron misrepresented its earnings to shareholders and employees alike. In the meantime, it was encouraging its employees to invest in Enron stock exclusively. The earnings reports looked positive to investors who continued to invest in Enron stock, even though the earnings were not accurate. Employees and investors had no means of ascertaining the facts. In hindsight, some postulate that the California energy debacle may actually have been manufactured by Enron.[34]

Apart from misrepresenting earnings, officials of the company embezzled money from the firm while reporting fraudulent earnings to investors. Eventually, the company went bankrupt because of fraudulent activities and embezzlement. This destabilized the American financial system as Enron was one of the top companies in the USA. As a consequence, many employees of Enron lost their entire retirement portfolios that were filled with Enron stock as the value plummeted. Investors lost the money they had invested in Enron stock.[35]

2.2.2 WorldCom

In 1985, Bernie Ebbers took control of a small southern company named Long Distance Discount Services, Inc. (LDDS) that was in debt. As the chief executive officer, Ebbers began an acquisition strategy in which the company acquired small long-distance companies with limited geographic service areas and in six months the company was profitable again. As LDDS grew, it required more buying power, to do so it turned to the public market for more funding. By going public in

[32] Kimberly Amadeo Deregulation Pros, Cons and Examples (2014) http://useconomy.about.com/od/glossary/g/deregulation.htm accessed on 26th August 2014
[33] Peavler Ibid note 33
[34] Peavler Ibid note 33
[35] Peavler Ibid note 33

1989, LDDS gained significant capital from the sale of shares of the company. In 1995, Ebbers renamed the company "WorldCom." In the late 90's, WorldCom's revenues had grown to more than $30 billion. The company was the largest internet provider in the world, as well as the major provider of network services to the United States Government.[36]

Ebbers and chief financial officer Scott Sullivan led WorldCom with a growth through acquisition strategy, with sixty five acquisitions in six years. However, WorldCom struggled to integrate many of the acquisitions and as a result; many did not do well. In order to make it appear that profits were in fact increasing, WorldCom used a liberal interpretation of accounting rules.[37] For example, the company would write down assets it acquired, while charging them against future earnings. This resulted in bigger losses in the quarter, but smaller losses in the future, effectively painting a picture of improved profitability. [38] Eventually, WorldCom could no longer hide the huge costs it had incurred in the troublesome acquisitions. In July 2002, WorldCom filed for bankruptcy protection, admitting to a total of $9 billion in adjustments for the period from 1999 through the first quarter of 2002.[39] Bernard Ebbers was charged with conspiracy, securities fraud and filing false statements with securities regulators. He was sentenced to 25 years in prison for the $11 billion accounting fraud that toppled the telecommunications company that emerged from bankruptcy as MCI Inc.

2.2.3 Tyco International

Tyco International was a security company incorporated in Switzerland, with United States operational headquarters in Princeton, New Jersey. In 1992, Dennis Kozlowski became chief executive of Tyco.[40] The board of the company gave Kozlowski a contract stating that he would not be dismissed if convicted for a felony, unless it directly damaged the company.[41]

[36]Zekany, Kay, Lucas Braun and Zachary Warder. "Behind Closed Doors at WorldCom: 2001." Issues in Accounting Education, Vol. 19, No. 1: Feb 2004.
[37] Moberg, Dennis and Edward Romar. "WorldCom." Markkula Center for Applied Ethics, 2003.
[38] Ibid
[39] Ibid
[40]He siphoned off some hundreds of millions in private expenditure. An infamous gold and burgundy shower curtain allegedly costing £6,000.00 and a lavish US $ 2 million toga party on a Mediterranean Island for his wife's birthday.
[41]Kozlowski authorized funding of US $ 4 million to support a chair in corporate governance at Cambridge University which he claimed was jointly funded by the company and himself. **Bob Tricker Corporate governance: principles, policies and practices second edition Oxford University press (2012)** Tyco's former CEO Dennis Koslowski, former CFO Mark Swartz, and former General Counsel Mark Belnick were accused of giving themselves interest-free

Kozlowski and Swartz were found guilty in 2005 of taking bonuses worth more than $120 million without the approval of Tyco's directors, abusing an employee loan program, and misrepresenting the company's financial condition to investors to boost the stock price, while selling $575 million in stock.[42] Kozlowski was fined US $ 70 million and jailed for up to 25 years.

In addition to the criminal charges against Mr. Kozlowski, Mark H. Swartz, was indicted on charges of helping Mr. Kozlowski misappropriate the company's funds. Mark A. Belnick, Tyco's former general counsel, was charged with falsifying company documents to conceal some $14 million in unauthorized pay. Frank E. Walsh Jr., a former Tyco director, pleaded guilty to securities fraud. He settled the case and avoided prison time by agreeing to repay the $20 million he had been secretly paid and to pay a $2.5 million fine.[43]

2.2.4 Arthur Andersen

Arthur Andersen was one of the world's top five largest accounting firms which went out of business following a number of audit failures, including Waste Management, WorldCom and Enron. After Enron collapsed, Andersen was accused of shredding Enron papers sought by the Securities and Exchange Commission investigation, and in 2002 it appeared before a grand jury on charges of obstructing justice, but was subsequently exonerated.[44] The U.S. Supreme Court overturned the conviction in 2005, but by that time Andersen had long since surrendered its licenses to practice and wound down its operations.[45]

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or very low interest loans that were never approved by the Tyco board or repaid. They were also accused of selling their company stock without telling investors, which is a requirement under SEC rules. Koslowski, Swartz, and Belnick stole $600 million dollars from Tyco International through their unapproved bonuses, loans, and extravagant company spending. Rumors of a $6,000 shower curtain, $2,000 trash can, and a $2 million dollar birthday party for Koslowski's wife in Italy are just a few examples of the misuse of company funds. Essentially, they concealed their illegal actions by keeping them out of the accounting books and away from the eyes of shareholders and board members. **Obringer, Lee Ann. "How Cooking the Books Works" 16 August 2005 http://money.howstuffworks.com/cooking-books10.htm accessed on 12th October 2014.**

[42] William H. Donaldson (2003) Testimony Concerning Implementation of the Sarbanes-Oxley Act of 2002 http://www.sec.gov/news/testimony/090903tswhd.htm accessed on 23rd August 2014

[43] Andrew Ross Sorkin and Alex Berenson Corporate Conduct: The Overview; Tyco Admits Using Accounting Tricks To Inflate Earnings (2002) http://www.nytimes.com/2002/12/31/business/corporate-conduct-overview-tyco-admits-using-accounting-tricks-inflate-earnings.html accessed on 12th October 2014

[44] Supra note 43

[45] Michael Rapoport Tax Firm to Revive Arthur Andersen Name Enron Scandal Brought Down Firm; Consultant Is Buying Rights to Use Name the Wall Street Journal (2014) http://online.wsj.com/articles/tax-firm-to-revive-arthur-andersen-name-1409626508 accessed on 13th October 2014

Clients quickly distanced themselves and many Andersen partners around the world smartly joined one of the remaining big four global audit firms. Andersen was left free to resume operations but the damage to its name was so severe, that it is unlikely to return to business. Even before voluntarily surrendering its right to practice before the Securities and Exchange Commission, it had many of its state licenses revoked.[46]

2.3 Corporate governance failures in United States of America

The fall of Enron, WorldCom and Tyco international among other companies was a direct consequence of failed corporate governance. This led to a complete re-evaluation of corporate governance practice in the United States.[47]

2.3.1 Enron

In Enron, Mr Kenneth Lay was both the Chairman and chief executive officer. [48] Kenneth Lay exercised a near complete control over the company's major decisions, with no relevant counterbalance at the board level to his views.

The Enron Board of Directors allowed Enron to engage in high risk accounting, inappropriate conflict of interest transactions,[49] extensive undisclosed off-the-books activities,[50] and excessive executive compensation. [51]

The independence of the Enron board of directors was compromised by financial ties between the company and certain board members. The board also failed to ensure the independence of the

[46] Ashley Nicholson and Daniel Edelman Arthur Anderson Auditors and Enron: What happened to their Texas CPA licenses? http://www.aabri.com/manuscripts/11899.pdf accessed on 11th September 2015

[47] Peter Grosvenor Munzig (2003) Enron and the Economics of Corporate Governance https://economics.stanford.edu/files/Theses/Theses_2003/Munzig.pdf accessed on 11th September 2015

[48] For a brief the two positions were separated when Mr Jeff Skilling functioned as CEO, and when he resigned in August 2001, Mr Lay again took on both roles.

[49] Despite clear conflicts of interest, the Enron Board of Directors allowed Enron's Chief Financial Officer to establish and operate the LJM private equity funds which transacted business with Enron and profited at Enron's expense. The Board exercised inadequate oversight of LJM transaction and compensation controls and failed to protect Enron shareholders from unfair dealing.

[50] The Enron Board of Directors knowingly allowed Enron to conduct billions of dollars in off-the-books activity to make its financial condition appear better than it was and failed to ensure adequate public disclosure of material off-the-books liabilities that contributed to Enron's collapse.

[51] United States Senate, The Role of the Board of Directors in Enron's Collapse, Report prepared by the Permanent Subcommittee on Investigations of the Committee on Governmental Affairs, 8 July 2002, p. 11

company's auditor, allowing Andersen to provide internal audit and consulting services while serving as Enron's outside auditor.[52]

Enron's audit committee also failed to oversee the work of the auditors and independently inquire into the workings of the organisation.

2.3.2 WorldCom

There was a major corporate governance failure in WorldCom because of its ineffective board,[53] lack of transparency, lack of internal controls and failure on the part of the auditor. WorldCom lacked transparency between the senior management and the board of directors. The board relied on insufficient information they received from the management without creating an environment which would have created an opportunity of learning of issues which required their attention.[54]

In spite of the company having a chairman, the chief executive officer, presided over the board meetings, determined board's agenda and its decisions, making it just an honorary title held by Roberts. The board of WorldCom was deceived because management had complete control over the board's agenda. The board of directors and its committee were just a rubberstamp for the ambitions of chief executive officer and chief financial officer.[55]

The audit committee failed to oversee the financial statements and make effective use of its internal financial department, further, the audit committee met only for three to five hours a year. This was insufficient to appreciate the company's accounting practices and function effectively.[56]

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[52] Leo Hindery It Takes a CEO: It's Time to Lead with Integrity Simon and Schuster(2005)
[53]The directors of WorldCom only attended the board meetings and had little or no involvement in company's business.
[53] Tyco International failed to file financial statements with the Securities Exchange Commission that conformed to Generally Accepted Accounting Principles and the rules and regulations of the Securities Exchange Commission.
[54]http://www.lawteacher.net/free-law-essays/company-law/principle-and-practice-of-corporate governance.php#ixzz3Y41AvEM3 accessed on 17th April 2015
[55] Ibid
[56] Ibid

2.3.3 Tyco International

Tyco falsified its financial reports in multifarious ways to create the impression of financial success through an intentional and undisclosed scheme to inflate financial results. Tyco's periodic reports of earnings and revenues and its financial projections[57] given to investors and securities analysts were materially false and misleading and omitted material information.[58]

In addition, Tyco failed to disclose in its annual Reports and in its proxy statements certain executive indebtedness, compensation, and related party transactions of Dennis Koslowski, Mark Swartz, and Mark Belnick. Tyco's executives gave themselves interest-free or very low interest loans sometimes disguised as bonuses that were never approved by the board of directors or repaid. Some of these loans were part of a Key Employee Loan Program (KELP)[59] the company offered and also from its relocation program.[60] They also sold their company stock without telling investors, which is a requirement under Securities Exchange Commission rules.[61]

Essentially, Tyco's executives concealed their illegal activities by keeping them out of the accounting books and away from the scrutiny of shareholders and board members.[62]

2.3.4 Arthur Andersen

Enron's financial statements were not prepared in accordance with generally accepted accounting principles (GAAP) and the financial statements did not present Enron's financial position. By

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[58]SEC Complaint: Tyco International 2006 https://www.sec.gov/litigation/complaints/2006/comp19657.pdf accessed on 18th April 2015

[59] Kozlowski and Swartz borrowed from the KELP for purposes not authorized by the program, including personal investments and extravagant purchases. The purpose of the KELP, according to its reports filed at the Securities Exchange Commission was to provide low interest loans to enable Tyco executives and employees to pay taxes due.

[60] The relocation loan programs were established to assist with real estate purchases by Tyco employees who were required to relocate from Tyco's New Hampshire offices to offices in New York City and, subsequently, to Boca Raton, Florida.

[61] Supra note 43 Obringer, Lee Ann. "How Cooking the Books Works" 16 August 2005 http://money.howstuffworks.com/cooking-books10.htm accessed on 12th October 2014

[62] Ibid

issuing unqualified opinions on the 1998-2000 Enron audits, Arthur Andersen made material misstatements in the audit reports. [63]

2.4 Effects of the corporate failures in the United States of America

The aftermath of corporate frauds such as Enron, WorldCom and Tyco International, the US government was quick to institutionalize corporate governance reforms together with revisions of the New York Stock Exchange's (NYSE) listing requirements. Notably, companies are now required to have an audit committee wholly comprised of independent directors and to publish a code of ethics for senior financial officers. While federal legislation is a major pillar in the enforcement of corporate governance, so is the Securities and Exchange Commission (SEC), whose rules supplement legislation. The SEC, set up in the years following the stock market crash of 1929, has overall oversight of financial markets and the accounting profession in the US. The listing rules of NYSE and National Association of Securities Dealers Automated Quotations (NASDAQ) are subject to SEC approval. Companies are also subject to the corporate law of the state in which they choose to incorporate, including requirements for independent directors and takeover laws.[64]

2.4.1 Legislative Intervention

2.4.1.1 The Sarbanes-Oxley Act of 2002

This Act was enacted in 2002 as a reaction to the corporate fraud. It introduced far reaching changes to corporate governance and the regulation of financial reporting that affected both publicly traded companies and their auditors. [65] Most of its provisions are specific to financial controls, auditing and accounting.[66]

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[63] Daniel Edelman and Ashley Nicholson Arthur Anderson Auditors and Enron: What happened to their Texas CPA licenses? http://www.aabri.com/manuscripts/11899.pdf accessed on 11th September 2015

[64] Supra note 43

[65] Elaine Harwood and Laura Simmons The Tenth Anniversary of SOX: Its Impact and Implications For Future Securities Litigation and Regulatory Enforcement Activity Corporate Accountability Report VOL. 10, NO. 28 JULY 13, 2012

[66]These include the following: independence of members of the audit committee; a bar on auditors carrying out specific types of non-audit work; revision of accounting standards for debts of SPEs; disclosure of off-balance-sheet transactions; and protection for whistle-blowers.

The Act requires certification of internal procedures, increased financial disclosure and applied criminal and civil penalties on directors for non-compliance. It applies to all United States and non United States companies listed in the United States of America. All public traded companies are required to submit an annual report about their internal accounting controls to the Securities and Exchange Commission.[67] Provisions of the legislation were incorporated into the New York Stock Exchange's corporate governance rules in 2003 and 2004.[68]

The Act addresses many of the issues highlighted by the accounting failures. It establishes the Public Accounting Oversight Board (PCAOB),[69] to oversee the auditing of public companies. The PCAOB requires all accounting firms that audit the financial statements of the Securities Exchange Act of 1934 to register with it and provide periodic reports. Registered accounting firms are subject to board-adopted audit, quality control and ethics standards, periodic inspections and possible disciplinary proceedings.

The Securities and Exchange Commission (SEC) adopted regulations regarding internal controls[70] of public companies in May 2003. Section 404 also requires that a company's independent auditors attest to and report on management's controls assessments, following standards established by the PCAOB.

Sections 302, 304, 802, 906, and 1102 prescribe the penalties for non-compliance. For example section 201 of the Sarbanes-Oxley Act prohibits external auditors from providing certain kinds of non-audit services to their auditing clients.[71] This is intended to reduce conflict of interest when an auditor is performing the auditing function.

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[67] Supra note 43
[68] Supra note 43
[69] Section 101-109 of the Sarbanes Oxley Act of 2002
[70] Section 404 of the Sarbanes Oxley Act of 2002
[71]Section 201(g) Except as provided in subsection (h), it shall be unlawful for a registered public accounting firm (and any associated person of that firm, to the extent determined appropriate by the Commission) that performs for any issuer any audit required by this title or the rules of the Commission under this title or, beginning 180 days after the date of commencement of the operations of the Public Company Accounting Oversight Board established under section 101 of the Sarbanes-Oxley Act of 2002 (in this section referred to as the `Board'), the rules of the Board, to provide to that issuer, contemporaneously with the audit, any non-audit service, including--
(1) bookkeeping or other services related to the accounting records or financial statements of the audit client;
(2) financial information systems design and implementation;
(3) appraisal or valuation services, fairness opinions, or contribution-in-kind reports;

Sections 302 and 906 of the Act sought to infuse accuracy in financial disclosure.[72] They catalogue a set of internal procedures.

Section 304 of the Act provides that if a company must restate its financial statements due to material non-compliance, misconduct, or with any financial reporting requirement, the chief executive officer and chief financial officer must reimburse the company for any bonus or other incentive-based or equity-based compensation received during the 12-month period following issuance of the financial statements, including restatements and profits realized from the sale of its securities during that 12-month period.[73]

Other provisions require the management to provide a report on the company's internal controls as part of the annual report. The report also contains an assessment of the effectiveness of the internal control structure and procedures for financial reporting.[74]

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(4) actuarial services;
(5) internal audit outsourcing services;
(6) management functions or human resources;
(7) broker or dealer, investment adviser, or investment banking services;
(8) legal services and expert services unrelated to the audit; and
(9) any other service that the Board determines, by regulation, is impermissible.
(h) A registered public accounting firm may engage in any non-audit service, including tax services, that is not described in any of paragraphs (1) through (9) of subsection (g) for an audit client, only if the activity is approved in advance by the audit committee of the issuer, in accordance with subsection (i).

[72] These sections require corporate CEOs and CFOs to certify quarterly and annual reports filed with the Securities and Exchange Commission (SEC). The certification states the CEO and CFO claim the following:

a) They have reviewed the report.
b) Based on their knowledge, the report is truthful and does not omit material information.
c) Based on their knowledge, the financial statements fairly present, in all material respects, the financial position, results of operations, and cash flows.
d) They are responsible for disclosure controls and procedures and have reviewed those procedures within the 90 days preceding the report filing date.
e) All material weaknesses in internal controls have been disclosed to the audit committee and the independent auditors. In addition, all known instances of fraud, material or not, that involve personnel involved with internal control have also been disclosed.
f) Significant changes to internal controls subsequent to the most recent evaluation have been disclosed, including corrective action with regard to deficiencies.

Intentional violation of this certification is subject to criminal penalties with fines of up to $5 million and up to 20 years in prison.

[73] If an issuer is required to prepare an accounting restatement due to the material noncompliance of the issuer, as a result of misconduct, with any financial reporting requirement under the securities laws, the chief executive officer and chief financial officer of the issuer shall reimburse the issuer for(1) any bonus or other incentive-based or equity-based compensation received by that person from the issuer during the 12-month period following the first public issuance or filing with the Commission (whichever first occurs) of the financial document embodying such financial reporting requirement; and (2) any profits realized from the sale of securities of the issuer during that 12-month period.

[74] Section 404 of the Sarbanes Oxley Act of 2002

Sections 802 and 1102 creates severe penalties up to 20 years imprisonment and or fines to punish those who disrupt an official investigation.[75]

The Sarbanes-Oxley Act has restored the integrity of financial reporting by removing the conflict of interest that existed before its enactment.[76] The Act imposes auditor independence standards in response to concerns that Andersen's audits of Enron may have been compromised by the fact that the accounting firm was earning more from Enron for consulting services than for auditing.

The Act also ended self-regulation of the public accounting industry by creating the Public Company Accounting Oversight Board. The board is responsible for monitoring public accounting companies, and works with the Securities Exchange Commission. Based on size, accounting firms undergo reviews every one to three years. In addition to board reviews, public accounting firms now carry personal liability for their audits.

Section 301 of the Act removed the relationships between auditors and the audited firm's chief executive officer and chief financial officer and has replaced them with the audit committee.[77] The Act further requires each member of the audit committee of a listed company to be independent. This ensures that an audit committee acts in an objective, impartial manner free from any conflict of interest or inherent bias or undue external influence.

Section 302 of the Act requires the Securities Exchange Commission to adopt rules requiring principal executive officers and principal financial officers of reporting companies to certify

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[75] Section 802 states that Whoever knowingly alters, destroys, mutilates, conceals, covers up, falsifies, or makes a false entry in any record, document, or tangible object with the intent to impede, obstruct, or influence the investigation or proper administration of any matter within the jurisdiction of any department or agency of the United States or any case filed under title 11, or in relation to or contemplation of any such matter or case, shall be fined under this title, imprisoned not more than 20 years, or both.
Section 1102 further provides that Whoever corruptly (1) alters, destroys, mutilates, or conceals a record, document, or other object, or attempts to do so, with the intent to impair the object's integrity or availability for use in an official proceeding; or
''(2) otherwise obstructs, influences, or impedes any official proceeding, or attempts to do so, shall be fined under this title or imprisoned not more than 20 years, or both.''

[76] Section 201 of the Sarbanes-Oxley Act prohibits external auditors from providing certain kinds of non-audit services to their auditing clients.

[77] The audit committee of a listed company shall be directly responsible for the appointment, compensation, and oversight of the outside auditor, and the auditors are to report directly to the audit committee.

quarterly and annual reports. The chief executive officer and chief financial officer must now verify that they have actually reviewed the report in question, that to their knowledge it does not contain material falsehoods or omissions, that the financial statements present the company's condition and operating results in a way that is fair and complete in all material respects, that they are responsible for and have evaluated internal controls, and that they have disclosed any significant control deficiencies to the external auditors and to the audit committee; in addition, they must also disclose certain changes in controls and corrective actions that have been taken. This provision was designed to promote more accurate and reliable financial statements.[78]

Significantly courts[79] have widely held that misstatements in financial reports, although certified by the chief executive officer and chief financial officer, are not sufficient evidence of scienter, and have set forth the predominant legal rule relied upon by the courts on this issue. A Sarbanes-Oxley certification is only probative of scienter if the person signing the certification was severely reckless in certifying the accuracy of the financial statements.[80] This requirement is satisfied if the person signing the certification had reason to know, or should have suspected, due to the presence of glaring accounting irregularities or other red flags that the financial statements contained material misstatements or omissions.[81]

2.4.1.2 New York Stock Exchange (NYSE)

Interestingly, the Sarbanes–Oxley Act does not address the issue of independent directors. The NYSE has dealt with these issues in its new listing standards (NYSE 2002).[82]

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[78] Section 302 of the Sarbanes- Oxley Act, 2002

[79] (Garfield v NDC Health, 2006; Central Laborers' Pension Fund v Integrated Electrical Services, 2007; Indiana Electrical Workers' Pension Trust Fund IBEW v Shaw Group, Inc., 2008; Western Pennsylvania Electrical Employees Benefits Funds v Ceridian Corporation, 2008; Glazer Capital Management, LP v Magistri, 2008; Zucco Partners, LLC v Digimarc Corporation, 2009). Garfield v NDC Health (2006)

[80] Section 302 of the Sarbanes Oxley Act, 2002

[81] In Garfield v NDC Health, 2006, the judge ruled that needed to be a distinction, otherwise "scienter would be established in every case where there was an accounting error or auditing mistake made by a publicly traded company"

[82] The majority of the board should have no material relationships with the company. Former employees of either the company or its auditor must wait five years before serving on the board. Directors must hold meetings without managers present. Nominating and compensation committees must be made up wholly of independent directors. The audit committee is to have sole responsibility for hiring the audit firm. Shareholders must approve all equity-based compensation.

2.4.1.3 Enforcement of Sarbanes-Oxley Act (2002)

The Act also provided new enforcement tools to combat corporate fraud, punish corporate wrongdoers and deter fraud with the threat of stiffer penalties. Because of the onerous obligations Sarbanes- Oxley Act imposed on listed companies and auditing firms, it is credited for having heralded the era of hard corporate governance.

2.4.1.4 U.S. Securities and Exchange Commission

The Securities and Exchange Commission (SEC) is an independent agency of the United States federal government established by the Securities Exchange Act, 1934. Its primary responsibility is enforcing federal securities laws. Others include proposing securities rules, and regulating the securities industry, the nation's stock and options exchanges, and other activities and organizations, including the electronic securities markets in the United States.

In addition to the Securities Exchange Act of 1934 that created it, the SEC enforces the Securities Act of 1933, the Trust Indenture Act of 1939, the Investment Company Act of 1940, the Investment Advisers Act of 1940, the Sarbanes–Oxley Act of 2002, and other statutes. The SEC was created by Section 4 of the Securities Exchange Act of 1934. [83]

In 2003, the Commission filed 543 enforcement actions, 147 of which involved financial fraud or reporting violations. During the period, the Commission sought to bar 144 offending corporate executives and directors from holding such positions with publicly held companies. The commission held accountable not just the companies that engaged in fraud, but other participants as well. [84]

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[83] A-Z Index of U.S. Government Departments and Agencies USA.gov 2014 http://www.usa.gov/directory/federal/S.shtml accessed on 12th October 2014

[84] Supra note 45

The enforcement authority given by Congress allows the SEC to bring civil enforcement actions against individuals or companies alleged to have committed accounting fraud, provided false information, or engaged in insider trading or other violations of the securities law. The SEC also works with criminal law enforcement agencies to prosecute individuals and companies alike for offenses which include a criminal violation.

2.4.1.5 Public Company Accounting Oversight Board (the "PCAOB")

This is a nonprofit corporation established by Congress to oversee the audits of publicly held companies in order to protect investors and the public interest by promoting informative, accurate, and independent audit reports. The corporation also oversees the audits of brokers and dealers, including compliance reports filed in accordance with federal securities laws. This is intended to promote investor protection.[85]

Establishment of the Public Company Accounting Oversight Board was a key innovation of the Sarbanes-Oxley Act of 2002. In addition to authorizing the PCAOB to inspect and set professional standards for public accounting firms,[86] the Act conferred broad discretion on the PCAOB to investigate and discipline firms or violations of the federal securities laws governing the preparation and issuance of audit reports, and other professional standards. The Act did so, however, without undermining the existing enforcement authority of the Securities and Exchange Commission over public company auditors.[87]

The PCAOB announced its first settled enforcement action against a registered public accounting firm in 2005 and by December 2011, it had settled 45 enforcement actions. Of the 45 public enforcement actions, 41 have settled disciplinary orders.[88]

The PCAOB enjoys expansive authority to investigate registered firms, associated persons, and numerous enforcement tools at its disposal. A review of the PCAOB's publicly disclosed actions shows that, in broad terms, the PCAOB's enforcement activities have focused principally on responding to perceived failures by PCAOB-registered firms or their associated persons to comply

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[85] Public Company Accounting Oversight Board
Section 101 of the Sarbanes-Oxley Act of 2002 There is established the Public Company Accounting Oversight Board, to oversee the audit of public companies that are subject to the securities laws, and related matters, in order to protect the interests of investors and further the public interest in the preparation of informative, accurate, and independent audit reports for companies the securities of which are sold to, and held by and for, public investors.

[86] The Sarbanes-Oxley Act of 2002, which created the PCAOB, required that auditors of U.S. public companies be subject to external and independent oversight for the first time in history. Previously, the profession was self-regulated.

[87] David B. Hardison and Paul H. Pashkoff United States: An Assessment Of The PCAOB's Enforcement Program To Date Under Sarbanes-Oxley (2012) http://www.mondaq.com/unitedstates/x/160592/Compliance+Regulatory+Forensic+Accounting/An+Assessment+Of+The+PCAOBs+Enforcement+Program+To+Date+Under+SarbanesOxley accessed on 5th September 2014

[88] Ibid

with professional standards during audit engagements, and addressing improper conduct by registered firms or their associated persons during PCAOB inspections or enforcement investigations.[89]

Importantly, 26 of the PCAOB's 45 publicly announced enforcement actions were failures by firms or individual auditors to comply with professional auditing standards during the course of an audit.[90]

The PCAOB has the authority to impose a broad complement of sanctions on registered public accounting firms or their associated persons.[91]

2.4.1.6 Sarbanes-Oxley Act

The Act created new penalties and described unlawful actions that amount to corporate fraud. The enhanced penalty provisions of the Act include new felony offenses; increased penalties for violations of securities laws; and mandatory review and amendment of the Federal Sentencing Guidelines to comply with the Sarbanes-Oxley requirements. [92]

The Act created new felonies and offenses. It also amended offenses in existing statutes.[93] Section 802 and 1102[94] prohibits company executives from knowingly and wilfully creating, altering, corrupting, mutilating, concealing, destroying, or falsifying company records with the intent to obstruct, impede, or influence federal proceedings, including bankruptcy proceedings. Although

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[89] Ibid
[90] Ibid
[91] Section 105(c)(4) of Sarbanes-Oxley Act (2002) a) revoking a firm's registration;
b)suspending or barring an individual from associating with a registered public accounting firm; placing limitations on a firm or person's business activities;
c)ordering civil money penalties;
d)imposing a censure;
e)requiring additional professional training;
f)requiring the engagement of an independent monitor to observe and report on the firm's compliance program; and/or
g) requiring the adoption or implementation of policies and procedures designed to improve audit quality or effectuate compliance with applicable laws, professional standards, or Board rules, including through the engagement of an independent consultant.
[92] Carol A. Rolf, Efficacy Of The Sarbanes-Oxley Act In Curbing Corporate Fraud Rivier College Online Academic Journal, Volume 1, Number 1, Fall 2005 pg 8 Https://Www.Rivier.Edu/Journal/ROAJ-2005-Fall/J11-ROLF.Pdf Accessed On 15th April 2015
[93] Ibid
[94] Supra note 67

this law existed prior to Sarbanes-Oxley and applied to ongoing investigations, under the Sarbanes-Oxley Act it also applies to prospective or future investigations to prevent destruction of records, as was the case in Arthur Andersen and Enron where executives destroyed some of Enron's audit records, thus making them unavailable in the Enron bankruptcy proceeding. Penalties for such violations are fines, imprisonment for a term of 20 years, or both.

The Act provides that it is unlawful for accounting firms to knowingly and wilfully violate section 302 of the Act and any related SEC rules by failing to maintain audit records and review work documents for five years. Violators are liable to fines, a maximum 10 year prison term or both.[95]

The Sarbanes-Oxley Act also added whistle blower protections[96] for those who inform or assist in securities violation investigations. Public companies are required to establish a mechanism that enables reporting of illegal acts. A publicly traded company may not knowingly retaliate[97] against a witness, informant, or victim who provides truthful information concerning commission of a federal offense by a company.

The Act sought to increase reporting accuracy by increasing the accountability of those responsible for the disclosures.[98]Section 304[99] is one of several enforcement provisions designed to increase internal investigation and create a penalty for inaccurate or incomplete reports. Whereas Section 302 creates an incentive for the CEO and CFO to ensure accuracy by attaching liability to their signature, section 304 creates a penalty for failure to discover corporate misconduct by directly targeting bonuses and incentive based compensation of the CEO and CFO. While section 304 does not directly punish a false signing like section 906, it is still operationally consistent with the duty

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[95] Section 802 of the Sarbanes- Oxley Act, 2002

[96] Section 1107 of the Sarbanes- Oxley Act, 2002.

[97]Whoever knowingly, with the intent to retaliate, takes any action harmful to any person, including interference with the lawful employment or livelihood of any person, for providing to a law enforcement officer any truthful information relating to the commission or possible commission of any Federal offense, shall be fined under this title or imprisoned not more than 10 years, or both.

[98] Larry E. Ribstein, Market vs. Regulatory Responses to Corporate Fraud: A Critique of The Sarbanes-Oxley Act of 2002, 28 J. CORP. L. 1, 3 (2002)

[99] Section 304 provides that "if an issuer is required to prepare an accounting restatement . . . as a result of misconduct," the CEO and the CFO shall reimburse the company by disgorging: (i) any bonus or other incentive-based or equity-based compensation received, and (ii) any profits realized from the sale of company stock, during the twelve-month period following the filing or public issuance of the financial statements that require restatement.

to obtain all material information about the company and ensure it is accurate and not misleading before issuing the report.

One of the most notable case is UnitedHealth Group and Chairman William McGuire, made headlines as the ultimate case for poor governance and corporate greed. Following a series of corporate financial restatements, the SEC charged McGuire from profiting on bonuses and other compensation based on falsified financial documents. In exercising its enforcement power under section 304, the Act found McGuire as having violated securities laws.[100] McGuire reimbursed UnitedHealth all incentive based equity and compensation received from 2003 to 2006 totalling close to $448M in cash.

The Global Financial Crisis of 2007-8 and resulting global recession of 2007-13 came as a major shock that is widely regarded as the worst financial crisis since the Great Depression of the 1930s. The crisis, started with the collapse of Lehman Brothers in September 2008 followed by several UK and European Banking Groups, threatened the global financial system with total collapse, led to the bailouts of many large uninsured financial institutions by their national governments. It occasioned sharp declines in stock prices, followed by smaller and more expensive loans for corporate borrowers as banks pulled back on their long-term and short-term credit facilities, and decline in consumer lending, as well as lower investments.[101]

Consequently, Congress passed the Dodd-Frank Act Wall Street Reform and Consumer Protection Act of 2009 that introduced changes in the regulation of the U.S. financial system.[102] The Act was enacted to promote financial stability of the US by improving accountability and transparency in the financial system. It brought about several amendments and additions to the law relating to executive remuneration, including shareholder approval for standard remuneration and golden parachute schemes,[103] and measures for ensuring the independence of compensation committees.[104]The SEC requires that relevant companies must disclose the remuneration of the

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[100]The SEC's new enforcement tool: SOX Section 304 (http://www.barneyandbarney.com/the-sec-s-new-enforcement-tool-sox-section-30/ accessed on 5th September 2014
[101] Anjan V. Thakor The Financial Crisis of 2007–09: Why Did It Happen And What Did We Learn? (2015)
[102] Ibid
[103] Section 951 Dodd-Frank Wall Street Reform and Consumer Protection Act of 2009
[104] Section 952 Dodd-Frank Wall Street Reform and Consumer Protection Act of 2009

CEO in relation to the financial performance of the company itself.[105] Lastly, policies regarding the recovery of any incentive-based remuneration which was awarded due to erroneous calculations in financial statements must be adopted and implemented.[106]

2.5 Impact of the Sarbanes-Oxley Act

The Sarbanes- Oxley Act created the Public Company Accounting Oversight Board (PCAOB) which was charged with direct oversight and regulation of the accounting industry. PCAOB works in tandem with the Securities and Exchange Commission (SEC) to oversee all public accounting firms and public companies.[107]PCAOB has the legislated authority to discipline any violators of Sarbanes- Oxley Act.

Sarbanes- Oxley Act contains several sections that directly limit the scope of services auditing firms are able to perform for public companies.[108]

Section 302[109], included several requirements related to the management of public companies. Both the chief executive officer (CEO) and the chief financial officer (CFO) are now required to take personal responsibility by personally certifying both the quarterly and the annual financial statements and disclosures.

Section 401[110] requires that all material off-balance sheet transactions and relationships with unconsolidated entities, which can or will have economic effects on the company, must be

[105] Section 953 Dodd-Frank Wall Street Reform and Consumer Protection Act of 2009

[106]Section 954 Dodd-Frank Wall Street Reform and Consumer Protection Act of 2009

[107]The mission of the PCAOB is to protect the interests of investors and further the public interest in the preparation of informative, fair and independent audit report.

[108]Section 201 restricts the scope of services auditing firms can provide. Traditional bookkeeping services, accounting information system design and implementation, actuarial services as well as most forms of managerial consulting not directly related to audits are prohibited for firms who are contracted to provide audit services. Further, the audit committee of the Board of Directors of the employing firm must pre-approve all audit and non-audit services provided by its auditors. To reduce potential conflicts of interest, Section 203 requires auditing firms to rotate the managing partner off a client's audit at least every five years when engaged in a long-term relationship. Further, Section 204 mandates that the accounting firm reports directly to the company's independent audit committee.

[109]The Commission shall, by rule, require, for each company filing periodic reports under section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m, 78o (d)), that the principal executive officer or officers and the principal financial officer or officers, or persons performing similar functions, certify in each annual or quarterly report filed or submitted under either such section of such Act.

[110]The Commission shall issue final rules providing that each annual and quarterly financial report required to be filed with the Commission shall disclose all material off-balance sheet transactions, arrangements, obligations (including

disclosed in the quarterly and annual reports. In addition, section 403 requires that any transaction involving management or principal stockholders needs to now be disclosed by the second business day of the transaction.

Section 404[111] requires the management to issue a statement in each annual report on its responsibility for and its current assessment of the company's internal control structure and the effectiveness of those controls. This section also requires the auditor to attest to, and make an assessment of management's report on the company's internal control effectiveness for financial reporting.

2.6 Corporate scandals in United Kingdom

In the United Kingdom, scandals that led to the collapse of big companies such as Maxwell, Polly Peck, Barings, affected the City of London and the financial market during the late 1980s. The collapse was attributed to weak governance systems, lax oversight by boards of directors, and too much control vested in a single top executive.

2.6.1 Polly Peck

In October 1990, Polly Peck, a UK quoted company, was placed into administration.[112] At the beginning of August 1990 the share price had stood at 418p, but by 20 September 1990 it had fallen to 108p. This represented a loss of nearly 75 per cent of their value in less than two months.

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contingent obligations), and other relationships of the issuer with unconsolidated entities or other persons, that may have a material current or future effect on financial condition, changes in financial condition, results of operations, liquidity, capital expenditures, capital resources, or significant components of revenues or expenses.

[111] (a) The Commission shall prescribe rules requiring each annual report required by section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m or 78o(d)) to contain an internal control report, which shall--

(1) state the responsibility of management for establishing and maintaining an adequate internal control structure and procedures for financial reporting; and

(2) contain an assessment, as of the end of the most recent fiscal year of the issuer, of the effectiveness of the internal control structure and procedures of the issuer for financial reporting.

(b) With respect to the internal control assessment required by subsection (a), each registered public accounting firm that prepares or issues the audit report for the issuer shall attest to, and report on, the assessment made by the management of the issuer. An attestation made under this subsection shall be made in accordance with standards for attestation engagements issued or adopted by the Board. Any such attestation shall not be the subject of a separate engagement.

[112] Polly Peck became insolvent and was placed into administration subject to an administration order made in the Chancery Division of the High Court on 25 October 1990 under s 8 of the Insolvency Act 1986.

Consequently, trading in the shares was suspended by the London Stock Exchange. The company collapsed with debts estimated at £1.3bn.[113]

2.6.2 Maxwell Corporation

The Maxwell 'empire' largely comprised of two publicly quoted companies Maxwell Communication Corporation and Mirror Group Newspapers. Heavy borrowing to finance the expansion of his publishing and media empires led to unsustainable levels of debt. Robert Maxwell had used his dominant position as chairman of the trustees of the group's pension funds to siphon off funds to support his other interests. It was also alleged that he had been involved in an illegal scheme to bolster the price of the companies in the group.[114] Debts of 4 billion pounds and 441 million pounds sized hole in its pension funds were eventually revealed.[115] The lead companies were declared insolvent, banks called in loans that could not be repaid, and the group collapsed.

2.6.3 Barings Bank

Nick Leeson was Barings Bank's star Singapore trader, bringing substantial profits from the Singapore International Monetary Exchange. By 1993, a year after his arrival in Asia, Leeson had made more than £10m - about 10% of Barings's total profit for the year. But in 1994, his luck began to wane when the markets turned against him, the downturn accelerated by the economic impact of the earthquake in Kobe, Japan.[116]

By autumn, losses stood at £208m. Leeson requested and obtained extra funds to continue his trading activities, as he attempted to extricate himself from the financial improprieties by more and more frenetic deals. Alerted by the requests, his bosses carried out a spot audit in February

[113] Supra note 32 The Serious Fraud Office (SFO) prepared a case against Asil Nadir, chairman and chief executive, accusing him of theft and false accounting, but before the trial commenced Asil Nadir dramatically fled the UK in 1993 for the comparative safety of northern Cyprus. He finally returned the the UK voluntarily for trial in August 2010 and was tried on 13 specimen charges of false accounting and theft totaling £34m. On 23rd August 2012, he was convicted of 10 counts of theft of £29m from Polly Peck and was sentenced to 10 years' imprisonment.

[114] Bob Tricker, Gretchen Tricker Business Ethics: A Stakeholder, Governance and Risk Approach Routledge (2014) pg 49

[115] Supra note 32

[116] BBC News Business: The Economy How Leeson broke the bank (1999) http://news.bbc.co.uk/2/hi/business/375259.stm accessed on 17th October 2014

1995 and discovered that losses amounted to more than £800m, almost the entire assets of the bank.[117]

The company faced collapse. Leeson obfuscated losses in a nebulous account called Error Account 88888, which went to different managers from the house accounts. When his activities were discovered, Leeson and his wife escaped to Borneo, then to Frankfurt, but he was arrested and extradited from Germany back to Singapore.[118]

Barings, the UK's oldest merchant bank, finally crashed and was bought for £1, by the Dutch banking and insurance group ING. Dozens of executives who were implicated in the failure to control Leeson resigned or were sacked. Leeson pleaded guilty to fraud and was sentenced to six and a half years in prison. After his conviction, Leeson wrote “Rogue Trader”, in which he condemned the practices that allowed him to gamble with such large amounts of money unchecked.[119]

2.7 Corporate governance failures

2.7.1 Polly Peck

Polly Peck’s collapse in 1990 was one of the main corporate scandals that instigated the 1992 Cadbury Report, the foundation of the modern UK governance regime. The report recommended separation of the roles of chairman and chief executive. More importantly, it recommended a majority of non-executive directors. Mr. Nadir’s £29 million theft from the company he managed demonstrates the disastrous consequences of concentrating corporate power and the power that one individual can exercise when the roles of chief executive and chairman are merged.[120]

Mr. Nadir authorized money transfers without consulting the Company’s board of directors. The money was transferred from Polly Peck’s bank accounts to subsidiaries and other companies, and was used to covert purchase of shares and share options in Polly Peck and other businesses by

[117] Ibid
[118] Ibid
[119] Ibid
[120] Nadia Boro Nadir’s Conviction Highlights Importance of Governance August 31, 2012

companies controlled by Nadir and his family. Payments were also made to banks so that they could make loans to companies owned or controlled by Nadir or which were part of the Nadir Family Trust.

2.7.2 Maxwell Corporation

Robert Maxwell held two main positions. He was the chief executive and chairman of Maxwell Communications from 1981 till 1991. Failure to separate the roles led to the over concentration of power which led to nefarious activities. He abused his powers and stole approximately £727 million from the pension funds of the companies he was in charge of as chief executive and chairman. [121]

2.7.3 Barings Bank

Barings collapse was as a result of its flawed internal controls and channels of accountability. The Bank did not have a proper system of control in place to oversee activities of employees. Moreover, there were no risk management procedures at the Singapore branch at the time. Further, a lack of active involvement by the Board and management of Barings, allowed Nick Leeson to accumulate losses from his trading activities that led to the collapse of 200-year old financial institution.

Leeson was responsible for both the trading and the settlement sides of the Singapore operations, which made it easier for him to conceal his contracts from his superiors.[122] The multiple roles Leeson played at the Bank with no oversight, allowed him to make false declarations to regulating authorities which sanctioned accumulation of losses.

2.8 Reforms in the United Kingdom (UK)

The corporate scandals in the UK, most notably the collapse of the Maxwell Publishing Group, Barings Bank, Polly Peck among others, heralded the reform of corporate governance by exposing the deficiencies of the operative system of governance.

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[121] http://www.lawteacher.net/free-law-essays/trading-law/failure-of-corporate-governance-law-essay.php accessed on 17th April 2015.

[122] Reinicke, Wolfgang H.Public Policy: Governing without Government? Washington, DC: The Brookings Institution (1998)

The Cadbury's Report of 1992 recommended self-regulation through codes rather than legislation: statutory measures would impose a minimum standard and there would be a greater risk of boards complying with the letter, rather than with the spirit, of the requirements.[123] This thinking has prevailed in the UK, with the initial adoption of a Code of Best Practice, followed by a number of further Committee reports and amendments to the Code. The current Combined Code on Corporate Governance was issued following the Higgs Report of 2002, which laid emphasis on the role of non-executive directors.

2.8.1 UK Corporate governance Code

In response to the corporate scandals, the Financial Reporting Council, the London Stock Exchange, and the accountancy profession set up the Cadbury Committee to look into the financial aspects of corporate governance by the Financial Reporting Council, the London Stock Exchange and the Accounting profession. The Committee reported in 1992 and concluded that the issue of corporate governance is not a matter for legislation. The Cadbury Report also produced a code of best practice divided into 19 provisions and 14 notes dealing with board of directors, and setting up of board committees' structure, remuneration, financial reporting and the relationship between the board and auditors. The Securities and Exchange Commission (SEC) Listing Rules in London were modified in compliance with the Cadbury Report and part of the Listing Rules was that companies are to state in their Annual Returns whether they have complied with the Cadbury Code or to explain why the non-compliance.[124]

A key aspect of the UK approach was that many of these principles of best practice were not defined by company law, but are from the Combined Code. They are, therefore, based on "soft law", i.e. a non-binding code of conduct to be monitored and enforced by shareholders. Arguably, not all aspects of corporate governance behaviour should be defined by the inflexible requirements of formal legislation. This is the genesis of the 'comply or explain' paradigm.

[123] Cadbury Report (1992). Report of the committee on the financial aspects of corporate governance otherwise known as the Cadbury Report 1992.
[124] Ibid

This approach, has allowed companies to apply the code flexibly, depending on particular circumstances, including size and complexity of the company and attendant risks.[125]The Code recommends that the board should be balanced between executive and non-executive directors, the latter making up half the board.

2.9 Enforcement of the corporate governance code

Effective monitoring and enforcement of a code begins with the availability of information on the corporate governance practices of individual companies. In this regard, the real innovation of the Cadbury Code rested less in its substantive recommendations which reflected governance practices of large UK companies at the time but more in the mechanism proposed to ensure adequate disclosure of compliance to the public. The ensuing London Stock Exchange (LSE) rule of mandatory disclosure based on the "comply or explain" matrix has made the corporate governance practices of British companies much more transparent and has forced companies to think about them carefully, since any departure from the code has to be publicly justified.[126]

Once information on code compliance is in the public domain, the British media plays an important role in analyzing it and informing investors of significant code breaches. Most countries rely on shareholders to monitor and enforce compliance with the corporate governance code. In the UK, this task is undertaken principally by large institutional shareholders pension funds, insurance companies, and asset management firms with assistance from the media and proxy voting research providers.[127]

Another essential attribute of the UK system is a supportive legal framework. In the UK, companies are generally permitted to engage in one-to-one discussions with their shareholders, particularly those with the largest holdings.[128] The Companies Act 2006 endows shareholders in UK-incorporated companies with substantial powers, enabling them to act decisively when necessary. Comparatively extensive voting rights, including the right to appoint and dismiss

[125]Supra note 81
[126]Simon C.Y. Wong Developing and implementing corporate governance codes Private Sector Opinion — Issue 10 (2008)
[127]Ibid
[128] Committee on the Financial Aspects of Corporate Governance (Cadbury Committee), 1992, Report with the Code of Best Practice Cadbury Report, Gee Publishing, London.

individual directors and, in certain circumstances, to call an extraordinary general meeting. Certain requirements relating to the annual general meeting, including the provision of information to shareholders and arrangements for voting on resolutions, are also set out in company law.[129]

Besides providing an enabling environment through the Companies Act and related legislation, the British government has also played an important disciplinary role through its occasional threats to impose statutory solutions if the private sector fails to do its part. In fact, a number of significant corporate governance reforms in the UK over the past two decades arose in response to threats by the government to enact legislation. These include the original Cadbury Code, the guidelines on executive remuneration, and, more recently, disclosure of voting records by institutional investors.[130]

This legislative framework is reinforced by the Listing Rules that must be complied with by companies listed on the main market of the London Stock Exchange and which are policed by the Financial Services Authority. The Listing Rules provide further rights to shareholders and require certain information to be disclosed to the market. For example, they also include a formal requirement to provide a corporate governance statement in the annual report, explaining how the company has applied the Combined Code. In the case of companies incorporated abroad but listed in the UK the firm must disclose how its domestic governance practices differ from those set out in the Code.

2.10 Impact of corporate governance reforms in UK

Regulation of corporate governance brought significant changes in corporate governance practice and structure in the UK. The proportion of non-executive directors has increased substantially in the past two decades.[131]

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[129] Rudyard Kipling The UK Model of Corporate Governance: An Assessment from the Midst of a Financial Crisis (2008) pg 4 http://www.iod.com/intershoproot/eCS/Store/en/pdfs/policy_publication_The_UK_Model_of_Corporate_Governance.pdf accessed on 13th October 2014

[130] Supra note 128

[131] Rahat Kazmi UK Corporate Governance Reform, Theory and New Stewardship Code (2014) http://www.slideshare.net/srahatkazmi/uk-corporate-governance-reform-theory-and-new-stewardship-code-lecture-by-rahat-kazmi accessed on 17th April 2015. The proportion of non-executive directors on the board rose from an average of about one-third in 1980/81 to one-half in 1995/96. By 2006, non-executive directors accounted for 60% of the board on average in the top 100 UK listed companies. Over half of the non-executive directors of these companies

An important consequence of the corporate governance reforms in the UK from the Cadbury Report has been the separation of the roles of chief executive and chairman.[132]

The Combined Code on Corporate Governance recommends that executive remuneration should be at a level sufficient to attract and retain executive talent. Additionally, a significant proportion should be directly related to corporate performance. It also introduces transparency in the reporting of executive pay to shareholders and, as a consequence, UK company reports today generally contain lengthy and detailed reports from the Remuneration Committee. [133]

2.11 South Africa

2.11.1 Fidentia

The Cape based asset management company, Fidentia, was placed under provisional curatorship by the Cape High Court in February 2007. At the time Fidentia Holdings and its two subsidiaries, Fidentia Asset Management and Bramber, were holding nearly two billion Rands of investors' money which they used for their own personal interests. [134]

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are current, or former, executive directors of the company, or of other similar companies; and there is no sign of any change in this proportion in the 1980s and 1990s. Over half of the non-executive directors of these companies are current, or former, executive directors of the company, or of other similar companies; and there is no sign of any change in this proportion in the 1980s and 1990s. Higgs (2003) reports that of the 3,908 non-executive directors of UK listed companies in 2002, 80% hold only one directorship and only 7% hold both executive and non-executive directorships in UK listed companies.

[132]Given the importance and particular nature of the chairman's role, it should in principle be separate from that of the chief executive. If the two roles are combined in one person, it represents a considerable concentration of power. The proportion of firms combining these roles fell from 74% in 1981 to 50% in 1996. **Martin J. Conyon and Simon I. Peck Board Control, Remuneration Committees, and Top Management Compensation The Academy of Management Journal Vol. 41, No. 2, Special Research Forum on Managerial Compensation and Firm Performance (Apr., 1998)** examine the top 100 UK listed companies and find that the proportion with the combined role of chief executive and chairman fell from 52% in 1991 to 36% in 1994. They also show that the proportion with a remuneration committee rose from 78% to 99%, and those with a nomination committee rose from 12% to 72%, over the same period. Almost all large UK listed companies have separate audit, remuneration and nomination committees.

[133] Andy Cosh and Alan Hughes UK CORPORATE GOVERNANCE AND TAKEOVER PERFORMANCE
Centre for Business Research, University of Cambridge Working Paper No. 357 December 2007
The median level of CEO remuneration rose from £222,000 in 1981 to £827,000 in 1996 for a sample of large UK companies. Amongst the top 100 UK listed companies in 2006, the median level of CEO remuneration was £1,017,000 and the bonus element had risen to over 35% of this part of the remuneration package. This rise in executive pay levels, particularly in the past decade, has been reinforced by the award of stock option and long-term incentive plans that were rare in the early 1980s. By 2006 the inclusion of these elements raises the average pay package of CEOs of Financial Times Stock Exchange 100 companies to £3.3m and the performance related element of the whole package has increased to about 80% .***financial Times, 15 May 2006.***

[134] Unfortunately the funding was made up of R 1.47 billion from the Living Hands Umbrella Trust, which paid out money invested in Fidentia by the Mineworkers‟ Provident Fund to orphans and widows of those who deceased in mining accidents. Another R 245 000 000 was invested by the Transport Education and Training Authority (TETA).

2.12 Kings Report

South Africa responded to corporate failures by developing a solid legislative and regulatory corporate governance framework to restore investor confidence and enhance corporate transparency and accountability. The main sources of corporate governance in South Africa are the King Reports on Corporate Governance, Acts of Parliament, particularly the Companies Act,[135] common law with rich and extensive case law pertaining to corporate governance and the rigorous Johannesburg Stock Exchange (JSE) Listings Requirements.[136]

The First King Report on Corporate Governance was published in 1994 by the Institute of Directors. It sought to assist companies and their directors by providing a comprehensive set of principles and guidelines to codify, clarify and in certain circumstances expand upon the common law principles of corporate governance.[137] The development continued with the second King Report on Corporate in 2002 being published and, most recently, with the release of the third King Report on Corporate Governance in 2009 which carried a non-legislative apply-or-explain approach.

The King Report on Corporate Governance specifically King III is considered to be the world's standard on corporate governance. It is not founded on legislation, but rather on practical principles and proven practices. Apart from adopting an apply-or-explain approach which is groundbreaking in itself, the King Report also views strong corporate governance as a product of ethical and effective leadership.

A team was set up by the Financial Services Board (FSB) which investigated Fidentia. The director of Fidentia as well as certain followers used much of the monetary funding received for personal interests and contravened a number of laws which govern the administration of a company, the manner in which asset management should be handled and the general methods of fund trust protection.
Lucian Mihai Carciumaru An Assessment Of The Impact Of Corporate Governance Codes And Legislation On Directors And Officers Liability Insurance In South Africa pg 96 www.insurancegateway.co.za/download/6415 accessed on 5th September 2014

[135] Companies Act 61 of 1973 and 71 of 2008

[136] Alexandrea Roman King III Report: How South Africa Revolutionised Corporate Governance (2014) http://www.anywherepad.com/king-iii-report-how-south-africa-revolutionized-corporate-governance/ accessed on 5th September 2014

[137] Dave Walker and Ina Meiring South Africa: King Code And Developments In Corporate Governance last updated 4 November 2010 http://www.mondaq.com/x/113790/Corporate+Governance/King+Code+And+Developments+In+Corporate+Governance accessed on 5th September 2014

Significantly, the King III Report also defies the norm by demanding more than a financial report. It requires entities to submit an integrated report that reflects economic impact and achievements in sustainability. The Committee believed that financial reports do not offer a complete picture of what entities do. For example, it's not enough for companies to look out for their shareholders' best interests. They should also report on and prove the positive impact they leave on the communities within which they operate.[138]

The King III Report accords entities more freedom by allowing them to select their own corporate governance practices, but also gives them more responsibilities by requiring them to produce integrated reports.[139] The combination of the apply-or-explain approach and the focus on sustainability leads to a higher level of accountability and transparency, the two things that strong corporate governance aims to achieve.[140]

2.13 Enforcement of the King Reports

South Africa relies on a self-regulation[141] corporate governance enforcement. King I and II reports were based on the comply or explain principle while King III Report was based on the apply or explain principle.[142] While the King Codes set out the basic requirements of corporate governance, they have not been given the force of an Act of Parliament. Nonetheless, the Codes have had an impact on how companies are managed and evaluated[143] partly because of mere voluntary compliance by companies and partly because enforcement of the King Codes recommendations is effected by the Johannesburg Securities Exchange which makes acceptance of the Codes one of

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[138] Supra note 133

[139] Principle 8.9 of King III report defines integrated reporting as the holistic and integrated representation of the company's performance in terms of both its finance and its sustainability.

[140] Moloi S T M, Assessment of Corporate Governance Reporting in the Annual Reports of South African Listed Companies, Published MSc Thesis, (UNISA 2008) 1-3.

[141] See *Minister of Water Affairs and Forestry V Stilfontein Gold Mining Co Ltd and Others* where the court referred extensively to the second *King Report* to determine if the directors had breached their duties. The case highlights the fact that, although the *King Report's* recommendations are not mandatory they are influential and can be used as a test to determine whether directors observed their fiduciary and statutory duties.

[142] PricewaterhouseCoopers (PwC), Corporate Governance in South Africa: A Comparison of the King Report 2002 and the Sarbanes-Oxley Act of 2002, 6-13.

[143] Institute of International Finance, Corporate Governance in South Africa-An Investor Perspective, September 2007. (IIF 2007) at http://www.iif.com/download.php?id=0N6SZ+azhm accessed on 5th September 2014

the Exchange's Listing Requirements as well as through other statutes particularly the Companies Act.[144]

The Companies Act provides for the removal of directors[145] who are considered unfit to serve as directors as well as for the disqualification of the directors.[146] It provides for a register of disqualified directors to be maintained by the Registrar of Companies.[147] This ensures that unsuitable individuals are not allowed to manage the company's affairs thus protecting the investors and other stakeholders' interests.

Furthermore, the power of the Minister to appoint inspectors to investigate the affairs of a company and to report is also an important regulatory mechanism for ensuring probity in the management of companies' affairs so that they are properly managed.[148]

A number of regulatory provisions ranging from compulsory disclosure in the case of directors' remuneration and other information in financial statements and annual reports, the requirement of shareholder approvals before certain decisions are made and personal liability for wrongful acts and stiff penalties have been set in the Companies Act as a way of enforcing compliance by directors.

2.13.1 Johannesburg Stock Exchange (JSE)

Because listed companies are required to comply with specific corporate governance requirements,[149] certain consequences follow where a listed company does not comply. Section 1 of the JSE Listings Requirements, empowers the JSE to grant, review, suspend or terminate a listing of securities or impose a fine on a listed company.

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[144] Bekink M, An Historical Overview of the Director's Duty of Care and Skill: From the Nineteenth Century to the Companies Bill of 2007, (2008) 108.
[145] Section 220 of Act 61 of 1973 and section 71 of the Companies Act 71 of 2008
[146] Section 162 of the Companies Act 71 of 2008
[147] Section 69 of the Companies Act 71 of 2008.
[148] Section 258(2) of the Companies Act 61 of 1973
[149] Section 3 of the Johannesburg Stock Exchange Listings Requirements.

The JSE may also publicly or privately censure a company or its directors, individually or jointly, disqualify a director from holding the office of a director of a listed company for any period of time, order the payment of compensation to any person prejudiced by the contravention or failure and thereafter may impose a penalty of up to R5 million on the company or its directors, individually or jointly.[150] The JSE may also, in its discretion and in such manner as it may deem fit, notify the public of any fact that the JSE considers to be in the public interest, including, but not limited to, the name of the member or employee of a member who has been found guilty of any charge and of the sentence imposed on such person.[151]

As a further deterrent measure, the Securities Services Act[152] increases significantly criminal penalties for wrongful conduct, to a fine not exceeding R50 million and imprisonment for a period not exceeding 10 years.[153]

If a company fails to comply with the JSE Listings Requirements, the JSE may suspend and/or terminate the listing of that company if it is in the public interest to do so. The JSE may also publicly or privately censure the company or its directors, individually or jointly, and thereafter may impose a penalty of up to R1 million on the company or its directors, individually or jointly. The good governance principles will also be enforced by shareholders where they play an active role in the affairs of the company.

The Companies Act imposes liability on directors[154] if it is found that they conducted the business of the company fraudulently or recklessly. Ignoring good corporate governance principles may

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[150] Grant Thornton South Africa, JSE Listings Requirements, available at http://www.gt.co.za/Publications/Effective-directors-guide/jse.asp accessed on 5th September 2014

[151] Section 1 of the JSE Listing Requirements.

[152] Act 36 of 2004

[153] Müller N, Financial Services Board Report (2005) available at ftp://ftp.fsb.co.za/public/documents/AReport08_2005.pdf accessed on 5th September 2014

[154] Section 77(3) (a), (b) and (c)A director of a company is liable for any loss, damages or costs sustained by the company as a direct or indirect consequence of the director having—a) acted in the name of the company, signed anything on behalf of the company, or purported to bind the company or authorise the taking of any action by or on behalf of the company, despite knowing that the director lacked the
authority to do so; b) acquiesced in the carrying on of the company's business despite knowing that it was being conducted in a manner prohibited by Section 22(1);
c) been a party to an act or omission by the company, despite knowing that the act or omission was calculated to defraud a creditor, employee or shareholder of the company, or had another fraudulent purpose.

arguably amount to fraud and/or recklessness. This provision is arguably an enforcement mechanism that can be used to ensure good corporate governance.[155]

2.14 Conclusion

Governance of corporations can be statutory based, or through a code of principles and practices, or a combination of the two. The United States of America has codified a significant part of its governance in the Sarbanes-Oxley Act. The statutory regime provides for legal sanctions for non-compliance.

Arguments against the "comply or else" regime are that a 'one size fits all' approach cannot logically be suitable because the types of business carried out by companies vary significantly. The cost of compliance is burdensome, measured both in terms of time and direct cost. Further, the danger is that the board and management may become focused on compliance at the expense of enterprise. It is the duty of the board of a trading enterprise to undertake a measure of risk for reward and improve the economic value of the company. If the board has a focus on compliance, the attention on its ultimate responsibility may be undermined.[156]

The 56 countries in the Commonwealth, including South Africa and the 27 states in the European Union (EU) including the United Kingdom, have opted for a code of principles and practices on a 'comply or explain' basis.[157]In addition certain governance issues are legislated. At the United Nations, the question whether the United Nations Governance Code should be 'comply or explain' or 'comply or else', was hotly debated. The representatives of several of the world bodies were opposed to the word comply, because it connoted that there had to be adherence and there was no room for flexibility.[158]

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[155] Professor Kathleen van der Linde, Personal Liability of Directors for Corporate Fault, 20 SA Mercantile Law Journal, 2008, p439

[156] Lindie Engelbrecht Corporate and Commercial/King Report on Governance for South Africa (2009) http://www.library.up.ac.za/law/docs/king111report.pdf accessed on 13th October 2014

[157]The Institute of Directors in Southern Africa 'King Report on Governance for South Africa' (2009) http://www.ngopulse.org/sites/default/files/king_code_of_governance_for_sa_2009_updated_june_2012.pdf accessed on 9th November 2016

[158] Supra note 148

The rule versus principle dilemma has been amplified by the global financial crisis, which has bolstered demands for more legally enforceable corporate governance like in the United States.[159]

[159] Supra note 43

CHAPTER THREE: LEGAL FRAMEWORK ON CORPORATE GOVERNANCE IN KENYA

3.1 Introduction

The recent financial scandals in Kenya are a clear manifestation of the country's inability to cope with the self-regulation of its corporations through corporate governance codes. In Kenya, companies have often been used as instruments of fraud, an example, is the Goldenberg scandal which cost Kenya approximately $4billion, roughly 10 per cent of its gross domestic product (GDP). Owing to the inefficiency of the legal system, among other factors such as corruption and political interference, investigations into the insolvency of these companies have not borne much fruit. Kenya's corporate governance legislation and its corporate governance code are inadequate for effective corporate governance and reducing the number of corporate failures.

3.2 Corporate Scandals

3.2.1 Uchumi

Founded in 1975 by three Kenyan parastatal companies[160], Uchumi was incorporated to create outlets for the equitable distribution of commodities and to create retail outlets for Kenyan manufactures. The shares of the company stock were listed on the Nairobi Securities Exchange (NSE) in 1992[161].

By 2000s the company was unable to meet its obligations to suppliers and was faced with increasing debt. It was placed under receivership and simultaneously shares were suspended from trading at the Nairobi Securities Exchange, closing down in June 2006 after 30 years of business. This was referred to as "one of the greatest corporate disasters in independent Kenya history". [162]According to the then Ministry of trade Permanent Secretary (PS) David Nalo, the Ministry was not notified of the Board's decision to close down the retail chain on May 31 2006[163].

[160] (a) **Industrial Commercial & Development Corporation** (ICDC) (b) **Kenya Wine Agencies Limited** (KWAL) and (c) **Kenya National Trading Corporation** (KNTC

[161] Puja Malhan An Empirical Study of Customers Expectations and Perceptions of Service Quality; A Case Study of Uchumi Megastores in Kenya International Journal of Management and International Business Studies. ISSN 2277-3177 Volume 4, Number 3 (2014), pp. 275-284

[162] "Kenyan shop chain shuts its doors". BBC News. 2 June 2006.

[163] "As the PS I was extremely surprised because the Ministry of Trade was not notified. We represented the interest of Kenyans through Kenya Wines Agency and ICDC which were state corporations,"

The PS wrote to the Attorney General (AG), the Anti-Corruption Agency and the Capital Markets Authority on June 2006, requesting them to institute investigations. He said the state through Kenya Wine Agencies Limited (KWAL) and Industrial and Commercial Development Corporation (ICDC) had 26.5 shares in Uchumi which was a public company.[164]

A taskforce comprising of the then PS Secretary for Trade, Solicitor General and Investment Secretary made a finding that Uchumi Supermarket ltd had collapsed on planned and ambitious expansion programme that led to serious cash flow problems.

In addition, the task force found there was inappropriate business model characterised by unsustainable merchandising policy. Other reasons, he said, were that there could have been a weak management and poor human resource policy as well as inappropriate financing policy.
In *Republic Vs Lloyd Masika and Uchumi Supermarkets and 13 others*[165] part of the board of directors was charged with the offence of conspiracy to defraud the supermarket chain and breach of public trust.

The government held shares in the retail chain indirectly through KWAL and ICDC investments with a shareholding of 26.6 percent.[166] The suspects were acquitted in 2007 for lack of evidence to support the charge.

One of the reasons why the accused in *Republic versus Chris Kirubi* were acquitted was because the court found that the directors did not breach any of the internal procedures of Uchumi Supermarkets Limited in approving the sale. Furthermore the Public Procurement Act and

[164] Carole Maina Uchumi closure due to poor cash flow, PS Friday, March 11, 2011 http://www.the-star.co.ke/news/article-69865/uchumi-closure-due-poor-cash-flow-ps#sthash.7vxgISHF.dpuf accessed on 2nd October 2014

[165] *Republic Vs Lloyd Masika and Uchumi Supermarkets and 13 others Criminal Case No. 900 0F 2008* The criminal charges arising from the alleged irregular sale of Uchumi Supermarket Aga Khan Walk branch that was sold to for Sh147 million and then leased back to the chain at an inflated monthly rent of Sh1.7 million. The former chairman, businessman Chris Kirubi in his defence claimed that the company resolved to sell its asset in order to inject funds into the company which was at the time facing severe financial crisis. He contended that Uchumi had power to acquire and dispose of property, sell and lease back premises it had disposed of and maintained that the decision to sell the store was supported by the management and the government through the Permanent Secretary in the Ministry of Trade who was kept abreast of the happenings.

[166] Rob Jillo Kirubi, 13 others acquitted in Uchumi May 24, 2011 http://www.capitalfm.co.ke/news/2011/05/kirubiothers-acquitted-in-uchumi-case/ accessed on 2nd October 2014

Regulations did not apply to the supermarket chain since a 26% shareholding in the company by the Government did not make it a state corporation.

The guidelines on Corporate Governance Practices by Public Listed Companies in Kenya applied to Uchumi Supermarkets ltd as it was a public listed company. The prosecution did not lend any evidence to show that the board flouted these guidelines. Further, they do not have the force of law and thus breach of the same does not attract civil or criminal penalties.

With regard to breach of public trust, the evidence produced in court proved that the government with 26 per cent shareholding held a minority interest. The court held that the supermarket chain was not a state corporation and thus the board did not breach public trust.

In sum, the court decision illustrates the continuous boardroom struggles between majority and minority shareholders. The legal framework on corporate governance is ill-equipped to confront these challenges.[167]

The appointment of a new management team headed by Jonathan Ciano and the infusion of Ksh. 675 million from the government and an extra Sh300 million from shareholders helped the company significantly. The aggressive marketing campaign to restore public confidence in the chain also helped. Commercial activity resumed after six weeks. The retail chain had returned to profitability and applied to the Capital Markets Authority (CMA), to re-list its shares on the Nairobi Securities Exchange by January 2011.[168]

Another case involving Uchumi was the charge of insider trading[169] against former Uchumi general manager Bernard Mwangi Kibaru. The former Kenya Commercial Bank (KCB) chief

[167] Kethi D. Kilonzo Uchumi case sheds light on corporate governance gaps in public companies June 10 2011 http://www.businessdailyafrica.com/Opinion-and-Analysis/-/539548/1177842/-/mr6wgu/-/index.html accessed on 2nd October 2014

[168] Wafula, David "Uchumi Plays Catch-Up In Battle for Shoppers" Business Daily Africa 26 January 2011 http://www.businessdailyafrica.com/Corporate-News/Uchumi-plays-catch-up-in-battle-for-shoppers/-/539550/1095852/-/lytyjlz/-/index.html accessed on 2nd October 2014

[169] *Republic –Vs- Terrence Davidson & another Criminal case no. 1338 of 2008*. CMA classifies insider trading as use of unpublished price-sensitive information to trade in listed shares an offence for which a first-time offender is liable to a Sh2.5 million fine, five years imprisonment or both.

executive, Terry Davidson faced a similar charge. However, the prosecution failed to prove the information was not generally available to the public. It was public knowledge that Uchumi was performing poorly when he sold his shares.

The accused persons were acquitted. The court observed that although the defence had demonstrated Uchumi's poor performance and the pulling out of its major shareholders, these were matters that had been publicized in the media, and the accused persons had not exploited such information for personal gain.

Approval to re-list on the Nairobi Securities Exchange was granted in May 2011 and trading in the shares of Uchumi Supermarkets ltd resumed on Tuesday 31 May 2011. [170]Trading in Uchumi shares was under five-year suspension from the Nairobi Securities Exchange.

3.2.2 Cooper Motors Corporation (H) Ltd (CMCH)

Despite its success and persuasive influence in the motor industry, the CMCH[171] seems to have gone a long way in misrepresenting to both the tax authorities and its shareholders.[172]

The Capital Markets Authority suspended trading of the shares at the NSE on September 16, 2011 and undertook a preliminary investigation on the issues raised which noted certain deficiencies

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[170] Wahome, Mwaniki "Uchumi Shares 'Expected' to Trade at Higher Value" Daily Nation 25 May 2011 http://www.nation.co.ke/business/news/-/1006/1169104/-/51fhciz/-/index.html accessed on 2nd October 2014

[171] Cooper Motor Corporation is a major player in auto assembly in the East African market. The motor firm enjoys a lucrative position as the exclusive distributor of major 4×4 brands including Land Rover. The company also owns CMC Aviation Ltd, alongside the CMC Aircarters subsidiary. CMC has a 33 percent stake in the inaugural auto maker in Kenya, the Kenya Vehicle Manufacturers Limited (KVM) which produces Japanese brands through order arrangements with clients. In addition, the motor firm is unrivalled in the East African Community market in terms of distribution of spares, service and sale particulars, reaching a wide distribution through its nine operational outlets in the country besides its other depot in Uganda. **Timothy Wahome Exit Lay, enter Ngige in CMC Kenya's latest high profile retirement 08 February, 2013** http://www.bizrika.com/news-item/exit-lay-enter-ngige-in-cmc-kenyas-latest-high-profile-retirement/ accessed on 2nd October 2014

[172] Events of the Company's losses came to light in 2011 following revelations that a few members of the board of directors had been swindling the company and stashing the loot in foreign accounts. Mr. William Lay, who moved to CMC from General Motors East Africa, was at the centre of the boardroom wars that forced the motor firm to replace nearly all its directors in a span of 18 months.

The chief executive, who had been at the helm of CMC Motors for only three months, spilled the beans on how had been disregard of corporate governance regulations, and how unnecessary expenditures and massive illegal dealings had hampered the growth of the company.

The sensational claims forced the capital markets regulator (CMA) to launch its own investigations into the motor firm as part of its mandate to protect investors and to uphold market confidence.

with regard to CMCH and thereafter commissioned an independent investigation which was conducted by Webber Wentzel South Africa (WW). CMCH also commissioned its own investigation conducted by PricewaterhouseCoopers (PwC) on some of the issues raised. The WW and PwC Investigations reports noted several inadequacies and failures with regard to the CMCH and/or its director's individually and/or collectively[173].

The Capital Markets Authority board appointed a five member Adhoc Committee[174] to give an opportunity to the persons adversely mentioned in the Reports[175].

All three investigations found that the directors had failed to protect the company's interests, and adopted no mechanisms even when it was 'obvious the management was running down the company'. [176]

CMC Holding shares were suspended from trading for another 85 days on 4th June 2014 to facilitate resolution of outstanding matters.

In reaction to this scandal Capital Markets Authority has installed certain measures to ensure discipline. For example, in order to be nominated as a director, a person is required to show proof

[173] Report and resolutions of the Board of the capital markets Authority regarding the Investigation into the affairs of CMC holdings limited **August 3, 2012**

[174] All persons adversely mentioned in the investigation reports had also been given an opportunity to be heard pursuant to section 26 of the Capital Markets Act.

[175]The Committee was appointed under Section 14 (1) of the Capital Markets Act which states that "the Authority may appoint committees, whether of its own members or otherwise, to carry out such general or special functions as may be specified by the Authority, and may delegate to any such committee such of its powers as the Authority may deem appropriate. The committee was to make recommendations to the board of the authority on findings and actions to be taken under the Capital Markets legal framework. *Justice (Rtd) Ringera said 'the CMCH case is an exhibit of an appalling failure of corporate governance.*

[176] Moses Michira End of an era as regulator ejects veteran directors August 5 2012 http://www.businessdailyafrica.com/End-of-an-era-as-regulator-ejects-veteran-directors-/-/539552/1471644/-/3sn6k3z/-/index.html accessed on 2nd October 2014. The forensic reports caused several directors among them Martin Forster, former managing director, Mr Sobakchand Shah, finance director and non- executive directors, former Attorney General Charles Njonjo, former Head of Civil Service Jeremiah Kiereini. Also affected was the immediate chairman of the board, Peter Muthoka, Richard Kemoli and Andrew Hamilton to be blacklisted and barred from sitting on any board of a listed company in Kenya. "That is the best thing that has happened in the corporate world since such fraudulent actions have eroded investor confidence at the NSE," Joel Kibe, Muthoka's successor terming the ban as the biggest move taken by the CMA ever. "One of our objectives in the next 100 days is to improve confidence in the market by ensuring that we promote good corporate governance," said Mr Gatabaki.

of attendance of recommended corporate governance workshops and thereafter training after 3 years, the age limit has been revised to 75 years.

3.2.3 East African Portland Cement

The East African Portland Cement Company Limited is a listed Company whose shareholding is divided among few shareholders as follows. Government 25%, National Social Security Fund (NSSF) 27%, Lafarge 41.7% and public 6.3 %.

The East African Portland Company held an Annual General Meeting (AGM) on 17th December 2013, where in the Board passed various resolutions which included endorsement of a dividend payment of 75% to shareholders, confirmation of the company accounts and endorsement of Didier Tresarrieu as a director. [177]

Two board members representing the government and NSSF wrote to the Capital Markets Authority (CMA) complaining about the manner in which the meeting was conducted at the AGM. Consequently, the regulator suspended the resolutions and trading in the shares.[178]

3.3 Legal framework of corporate governance in Kenya

3.3.1 Companies Act

The guidelines on corporate governance practices by public listed companies in Kenya is statutorily provided for in the Companies Act[179] and enforced by Capital Markets Authority

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[177] **Herbling David CMA moves to probe Portland after chaotic AGM 'Business Daily' 18th December 2013** Two board members representing the government and NSSF stormed out of the board meeting. This is because the government had issued a notice of intention proposing the board to be increased from 7 members to 11 members and election of Mr. Bill Lay as director yet this was not considered. They wrote to the CMA complaining the manner in which business was conducted in the AGM. The regulator suspended trading of company shares.

[178] A suit was filed by the Company against the government CMA and NSSF challenging the decision of CMA to suspend trading and they wanted the court to quash the decision of CMA. The government through the Attorney General filed a preliminary objection on the grounds that the suit was not properly before the court on grounds that the resolution sanctioning the filing of suit was not signed by majority of Directors. The court ruled against the company in favour of the government. Later on the President vide a special gazette notice appointed Bill Lay to be director and chairman of the company. The Company filed suit contesting the appointment but the court held in favour of the government stating that it was within the powers of the Executive to appoint Chairperson of State Corporation.

179 The Companies Act Cap. 486 Laws of Kenya deals with directors' duties and shareholder protection among other matters pertaining to corporate governance in Kenya.

through the Capital Markets Authority Act.[180] For Public listed companies, the point of reference on statutory law, governing corporate governance is embodied in the two acts as well as other regulations[181].

The Companies Act is a carbon copy of UK's Companies Act 1948. The duties of directors in Kenya are governed by the common law of UK companies. Under common law, directors' duties in common law are divided into the duty of care and skill and the duty of loyalty. The duty of care and skill[182] represents an attempt to regulate the entrepreneurial side of directors' activities. The duty of loyalty,[183] on the other hand, mainly encompasses the duty of good faith, the no conflicts of interest and the rule against managerial opportunism[184]. The duty of good faith requires that directors to exercise their powers in the best interests of the company.[185]

The Act[186] provides that directors are personally liable for misstatements in company prospectus and thereafter it[187] offers the same directors with an assortment of defenses to the effect that they can avoid liability if the prospectus was issued without their consent, or where they withdrew their consent, or relied on a public official document.

Shareholders are left unprotected by this provision, in that where a shareholder has relied on incorrect information in the company's prospectus, they can only be compensated if it can be shown that the director was aware of the misstatements in the prospectus or that the director

[180] Cap. 485A Laws of Kenya Sections 11(3) (v) and 12 of the Capital Markets Act.

181 Through Legal Notice No. 3362/2003, the CMA introduced guidelines on corporate governance practices by public listed companies in Kenya. Others are the Nairobi Securities Exchange (NSE) Regulations and the Penal Code, Cap. 63

[182] Doughlas Y. Park Fiduciary duties of the Board of Directors: The Basics August 2011 www.dyadvisors.com/2011/08/22/fiduciary-duties-of. The duty of care requires directors to make a business decision based on all available and material information and to act in a deliberate and informed manner. First, the board must act in good faith for the company's best interest. Second, they must believe that the actions promote the best interest of the company based on a reasonable investigation of the options available.

[183] The duty of loyalty imposes on the board an affirmative duty to protect the interests of the corporation, and also an obligation to refrain from conduct which would injure the corporation and its shareholders. Directors must avoid any conflict between duty and self-interest. Undivided allegiance to the corporation's best interest is required.

184 Managerial opportunism is basically when a person takes advantage of a management position and tries to get their in any manner that they can.

[185] Supra Note 184

[186] Section 45(1) Companies Act cap 486, Laws of Kenya. See also Section 30D and E of the Capital Markets Authority Act CAP 485A Laws of Kenya

[187]Section 45 subsection 2 of the Companies Act cap 486, Laws of Kenya.

consented to the issuing of the prospectus.[188] The burden of proof here rests with the shareholder, who usually has access to little or no information on the activities of the company. The shareholders fate in this case is sealed by the following section whose punishment is so lenient to an ordinary director.

Section 188 which deals with the appointment of directors, states that a person who has been declared bankrupt, and acts as a director of a company without leave of court, shall be liable to imprisonment for a term not exceeding two years or a fine not exceeding Kshs. 10,000 or both. Further, subsection 2 of the same section states that for leave to be granted the bankrupt individual must show that he may safely[189] be involved in the management of companies. It therefore implies that a bankrupt who has not been discharged[190] is not prohibited from acting as a company director with leave of the court.

Section 189[191] offers a loophole for persons guilty of fraudulent acts to act as a director at the discretion of court and cannot be barred from acting on the grounds of those previous fraudulent acts for a period of five (5) years.

Section 318 of the Companies Act further absolves directors' liability by providing that directors can be exempted from liability for offences that are discovered during liquidation if they had no intention to defraud the company, or to conceal the company's state of affairs. This 'intention to defraud' is difficult to prove.

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[188] In terms of liability for breach of disclosure obligations, the common law starting point is *Derry v. Peek (1889) L.R. 14 App. Cas, 337 (H.L.)*, in which the directors of a company seeking to raise capital made an honest but unreasonable statement in a prospectus that the company had authority to use steam power for its carriages. In fact, the authorization was conditioned on consent, and that consent was subsequently denied. The House of Lords held that the directors were not liable for damages as there was no proof of fraud an honest belief on their part, though unreasonable, was insufficient for liability to attach as long as it did not reach the level of recklessness. **Paul L. Davies, Gower's Principles Of Modern Company Law** 429 Sweet & Maxwell (6th ed., 1997)

189 It states, 'The leave of the court for the purposes of this section shall not be given unless notice of intention to apply therefore has been served on the official receiver, and it shall be the duty of the official receiver, if he is of opinion that it is contrary to the public interest that any such application should be granted, to attend on the hearing of and oppose the granting of the application.

190 A discharge in bankruptcy law is a statutory injunction against commencement or continuation of an action to collect, recover or offset a debt as a personal liability of the debtor.

191 Section 189 of the Companies Act suffers from the same limitations as Section 188 of the Companies Act as it does not prohibit management who commit fraud from acting as directors of public listed companies.

The challenges posed by the Act continue to be evident in section 402.[192] This Section suggests that directors can go scot free as a result of negligence arising from their ignorance or inexperience. It is also not strange that the courts, with the discretionary powers, have already ruled that directors are only required to exhibit a degree of skill and care that may reasonably be expected from a person of their knowledge or experience, but they are not liable for errors of business.[193]

Section 200 of the Companies Act[194] requires a director who is directly or indirectly interested in a contract or proposed contract with the company to declare the nature of his interest at a meeting of the directors of the company. At common law, where a director has not declared his interest in a contract, the contract itself becomes avoidable at the option of the company. The company can decide to continue with the contract or not or repudiate. If the director in question has made secret profits on the contract, the benefits must be accounted to the company.

3.3.2 Penal Code

Criminal liability is rather stringent though as the Penal Code provides for imprisonment for seven years for directors who knowingly give false statements with the intention to defraud a company[195].

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[192] It provides that 'if in any proceedings for negligence, default, breach of duty or breach of trust against an officer of a company and it appears to the court hearing the case that that officer is or may be liable but that he has acted honestly and reasonably he ought fairly to be excused partly or wholly at the discretion of the court'.

193 Flagship Carriers Limited vs. Imperial Bank (Civil Case No.1643 of 1999), unreported, High Court

[194](1) Subject to the provisions of this section, it shall be the duty of a director of a company who is in any way, whether directly or indirectly, interested in a contract or proposed contract with the company to declare the nature of his interest at a meeting of the directors of the company.

(2) In the case of a proposed contract the declaration required by this section to be made by a director shall be made at the meeting of the directors at which the question of entering into the contract is first taken into consideration or if the director was not at the date of that meeting interested in the proposed contract, at the next meeting of the directors held after he became so interested, and in a case where the director becomes interested in a contract after it is made, the said declaration shall be made at the first meeting of the directors held after the director becomes so interested.

(3) For the purposes of this section, a general notice given to the directors of a company by a director to the effect that he is a member of a specified company or firm or acts for the company in a specified capacity and is to be regarded as interested in any contract which may, after the date of the notice, be made with that company or firm or with himself in such specified capacity shall be deemed to be a sufficient declaration of interest in relation to any contract so made:

Provided that no such notice shall be of effect unless either it is given at a meeting of the directors or the director takes reasonable steps to secure that it is brought up and read at the next meeting of the directors after it is given.

(4) Any director who fails to comply with the provisions of this section shall be liable to a fine not exceeding two thousand shillings.

(5) Nothing in this section shall be taken to prejudice the operation of any rule of law restricting directors of a company from having any interest in contracts with the company.

195 Section 329 of the Penal Code

Prosecutions at the request of shareholders, particularly minority shareholders, are difficult to bring since the legal rights belong to the company and not its members and for that reason, only the company may institute proceedings for redress[196].

Courts have ruled that such suits can only be instituted on behalf of minority shareholders where a wrong is done to an individual and in all other cases, only the company can sue the criminal director[197]. The penalties within the Penal Code like those in the Companies Act effectively exonerate directors from liability by requiring shareholders to prove the director's dishonest intention, which is difficult. In the United States of America (USA), an attorney can bring proceedings on behalf of minority shareholders without the consent of the directors of the company[198] while an advocate in Kenya cannot bring proceedings against a company on behalf of the shareholder without the authority of the board.[199]

Consequently, these sections give company directors no incentive to ensure that they exercise due diligence in the performance of their duties, thus diluting the Act's resolve to enforce this aspect.

3.3.3 Corporate Governance Code

Kenya's guidelines on Corporate Governance Practices by Public Listed Companies in Kenya is enforced by the Capital Markets Authority, which are the result of a combination of ideas from corporate governance codes from different jurisdictions. [200]

"These guidelines have been developed taking into account the work which has been undertaken extensively by several jurisdictions through many task forces and committees *including but not limited* to the United Kingdom, Malaysia, South Africa, Organization for Economic Cooperation and Development[201] and the Commonwealth Association for Corporate Governance" [202]

196An exception to this is allowed where majority of share are controlled by those against whom relief is sought in particular where they have acted fraudulently or *ultra vires* in excess of their powers.
197 Musa Musango vs. Eria Musigire[1966] E.A. 390, ruling by Sir Udo Udoma C.J.
198 E.K. Scott 'Corporation Law and the American Institute Corporate Governance Project' Stanford Law Review (1983).
199 East African Portland Cement Ltd v Capital Markets Authority & 4 others [2014] eKLR
200 Supra note 15 pp 213-227
201 OECD, OECD Principles of Corporate Governance (2004), p.11.
202 Section 13 of the CMA guidelines

The Guidelines encourage listed companies to embrace a positive corporate culture of accountability and responsiveness to the interests of investors. The fact that non-compliance with the Guidelines is largely inconsequential was intended to engender them to listed companies. The Guidelines provide an array of mechanisms to enhance corporate governance. To reduce the overconcentration of power in the hands of one person, the Guidelines provide for the segregation of the office of the chairman of the board from that of the chief executive of the company.[203]

Corporate governance codes recommend that the positions of the chief executive officer and the chairman of the board (chairman) are separated, because to have one person occupying both the roles of the chief executive officer and chairman is to concentrate too much power in one person's hands, therefore making the company vulnerable to abuse. It is doubtful, however, whether splitting the role of the chief executive officer and chairman is likely to solve the corporate governance problem in Kenya.[204] The Capital Markets Authority Guidelines clearly state the role of the chairman and the role of the chief executive officer.[205]

The ineffectiveness of the splitting of the roles of chief executive officer and chairman is reinforced by the fact that there is no sanction in the Capital Markets Authority Guidelines for non-compliance with the Guidelines. The Capital Markets Authority Guidelines adopt the "comply or explain" principle, which is based on the assumption that the market will monitor compliance with the code and either penalize non-compliance by lowering share prices or observe that non-compliance is justified in the circumstances of the particular company.[206]

The lack of sanctions within the Capital Markets Authority Guidelines is further exacerbated by the current state of Kenya's Companies legislation. Kenya's companies legislation waters down the Capital Markets Authority Guidelines mechanisms by providing a subjective standard of liability

[203] Supra note 14 pg. 98

[204]Section 2.2.1 of the CMA Guidelines provides that:"… [T]here should be a clear separation of the role and responsibilities of the chairman and chief executive … where such roles are combined a rationale for the same should be disclosed to the shareholders in the annual report of the Company."

[205] Section 3.1.1 of the CMA Guidelines

[206] I. MacNeil and X. Li, "'Comply or Explain': market discipline and non-compliance with the Combined Code" (2006)14(5) Corporate Governance: An International Review 486.

for breach of directors' duties which takes away any incentive that directors and management may have to act in the interests of the company.[207]

The Capital Markets Authority Guidelines[208] provides that they have been developed as a response to the recognition of the role of good governance in “maximization of shareholders value as well as protection of investors’ rights”. The focus of the Guidelines appears to be on shareholders rather than stakeholder interests. [209]

It is arguable that the Capital Markets Authority Guidelines, within the context of the regulations governing foreign ownership, were not serving the interests of the Kenyan community who are the stakeholders of the companies listed in the stock exchange. Recently the legal threshold of foreign ownership of a public listed company in Kenya has been reduced from 75 per cent to 60 per cent.[210] This reduction has been controversial with the Government seeing the increase of local ownership to 40 per cent as an incentive to the local investor to participate in the Nairobi Securities Exchange while others see the reduction of the margin of foreign ownership in public listed companies as a disincentive to prospective foreign investors.

The collapse of Uchumi was attributed to a dysfunctional board. Dysfunctional boards have also been associated with corporate governance failures in well-established corporate governance regimes, such as those present in developed countries like the United States. In the collapse of Enron in the United States, directors failed in monitoring the activities of the management of Enron and its financial affairs, by mainly relying on the explanations of management because they trusted them and did not question the information that was given to them.[211]

Eshiwani[212] characterizes typical non-performing boards in Kenya as having directors who are always present at company meetings, as executive remuneration takes the form of an allowance

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[207] Supra note 200
[208] Section 1.1 of the Capital Markets Authority guidelines
[209] This is confirmed by s.3 of the CMA Guidelines, which provides that:
“… [T]he adoption of international standards in corporate governance best practice is essential for public companies in Kenya in order to maximize shareholders value …”
[210] Legal Notice 98 of 2007 referring to para.3(a) published on June 14, 2007.
[211] Supra note 32
[212] Supra note 20

awarded for each meeting attended. Age-wise, the members of the board are typically elderly people and the discussion that takes place for the better part of the meeting has little to do with the objectives of the company. Some executives perceive taking up a board position as being a form of semi-retirement. With this type of board where executive remuneration is not tied to firm performance, it is, almost inevitable that there will be misappropriation of company assets and a lack of strategy leading to underperformance of corporations as management will be able to prioritize their remuneration over company performance leading to underperformance and the possible collapse of corporations.[213] The collapse of Uchumi has been attributed to irrational expansion plans by the board coupled with a lack of risk management strategies.

An independent director must not have been employed by the company as an executive within the last five years.[214] Section 2.1.4.1 of the Capital Markets Authority Guidelines contradicts itself in that it implies that former directors can be considered an independent director as long as the board discloses this. This provision gives room for weak leadership on the board where management may seek to usurp the authority of directors. A former director acting as an independent director on the board is not likely to criticize the decisions of the current directors owing to the fact that doing so may reveal the shortcomings in the board at the time the individual in question was director. This reflects a similarity in weakness between the Capital Markets Authority Guidelines and the provisions on director liability in the Companies Act 1962.[215]

The Capital Markets Authority Guidelines also establish the office of independent non-executive directors (NEDs). Independent directors have long been perceived as the panacea for many corporate governance challenges. Their envisioned role was that of oversight and monitoring of executive directors as opposed to whistle blowing. The theory behind the creation of an independent corporate constituent was to enhance corporate governance by monitoring the excesses of executive directors and safeguarding minority interest. It was contemplated that their

[213] R. Gustavson, N.N. Kimani and D.A. Ouma, "The Confluence of Corporate Governance and Business Ethics in Kenya: A Preliminary Investigation", 5th BEN-Africa Conference, 2005, Kasane, Botswana, p.8

[214] Section 2.1.4.1(ii) then goes on to say that a director will be considered to be independent if the director:"… has not had any business relationship with the Company (other than service as a director) for which the Company has been required to make disclosure.

[215] Supra note 32

independence would strengthen the corporate governance structure. Their interpersonal skills, sound knowledge, advice, comments and counsel would widen the issues considered by the board and avoid conflict of interest. More specifically, they were expected to bring to bear an independent judgment on questions of strategy, performance of the company, resources, key appointments and standards of conduct. This was the foundation of their monitoring role. [216]

The Capital Markets Authority Guidelines[217] deals with board balance by requiring that the board should be composed of at least one-third of independent and non-executive directors of diverse skills or expertise in order to ensure that no individual or small group of individuals can dominate the board's decision-making processes. The role of a non-executive director in the Capital Markets Authority Guidelines is defined by what they should not do, as opposed to what they should do.

Section 2.1.4.2 of the Capital Markets Authority Guidelines provides that a non-executive director is "a director who is not involved in the administrative or managerial operations of the Company". Other than section 2.1.4.2 of the Capital Markets Authority Guidelines, the role of non-executives is to sit in committees within the board, such as the remuneration committee, the audit committee and the nomination committee. The Capital Markets Authority Guidelines should be reviewed to reflect the monitoring function of non-executive directors to facilitate their effectiveness as monitors, rather than passive members of the board by clearly defining their role as monitors.

The Capital Markets Authority Guidelines[218] appears to strengthen the monitoring function of non-executive directors and independent directors as an internal control mechanism in corporate governance by allocating them the role of recommending executive remuneration. The Capital Markets Authority Guidelines, however, need to be revised in order to give non-executive directors more independence in the performance of their duties and also be reviewed to reflect the monitoring function of non-executive directors to facilitate their effectiveness as monitors, rather than passive members of the board by clearly defining their role as monitors. The Capital Markets Authority Guidelines[219] recommends that the board should have a nomination committee whose

[216] Supra note 14
[217] Section 2.1.4 of the Capital Markets Authority Guidelines
[218] Section 3.1.4 of the Capital Markets Authority Guidelines
[219] Section 3.1.3 of the Capital Markets Authority Guidelines

role is to appoint members of the board. One of the problems that nomination committees face is the lack of diversity in the pool of potential directors. There are few candidates who can meet the requirements of s.3.1.3 (ii) of the Capital Markets Authority Guidelines which provides that the nomination committee should only consider *"persons of caliber, credibility and who have the necessary skills and expertise in exercising independent judgment".* The term "caliber" is often interpreted as meaning persons of high social standing; with research showing that appointment to boards in Africa is often political and based on "know who" rather than "know how". The Capital Markets Authority Guidelines[220] provide that in appointing members of the board, the nomination committee should ensure that: "The process of the appointment of directors should be sensitive to gender representation, national outlook and should not be perceived to represent single or narrow community interest."

This reflects a need for more female representation on Kenyan boards, as the majority of board members are male. There is also a need for age-balance within the board, as this brings with it different views and skills that can contribute to the company's success.[221]

The examination of the effectiveness of the law that governs companies as well as Kenya's corporate governance, demonstrates that Kenya lacks a corporate culture. This lack of corporate culture can be attributed to the lack of national values. It has been argued that Kenyans identify more with their tribes than they identify themselves with being Kenyans.[222] For corporate governance, this implies that having a board that represents a tribal bias will lead to the interests of a particular community overriding the interests of the shareholders.

3.4 Enforcement of Corporate Governance

3.4.1 Capital Markets Authority

Capital Markets Authority was set up in 1989 as a statutory agency under the Capital Markets Authority Act Cap 485A now. The Capital Markets Authority has broad ranging powers to oversee

[220] Sections 3.1.3(viii) of the Capital Markets Authority Guidelines
[221] Supra note 15
[222] R. Gustavson, N.N. Kimani and D.A. Ouma, "Perceptions of the Anglo-American Model of Corporate Governance in Sub-Saharan Africa:A Pilot Study", Workshop on Corporate Governance, Regulation and Development, University of Manchester, November 17, 2006, p.26.

market participants and issue new regulations. They approve new licenses, listings, takeovers and other transactions; engage in ongoing market surveillance; and undertake regular inspections. They investigate complaints, and refer cases to the Attorney General and issue reprimands and fines for non-compliance with regulations, but do not engage directly in prosecution. [223]

Capital Markets Authority has worked to improve market confidence by laying out rules and regulations to govern operation of players in the Nairobi Securities Exchange market. For a longtime, disclosure requirements were insufficient and there was inadequate protection of investors. At the same time, outdated laws and cumbersome licensing complicated entry, impeded efficient operation and discouraged orderly exit.[224]

In 2002, Capital Markets Authority, embarked on the development of a new regulatory framework that conforms to the best international practices.[225] Of the rules so developed, the key ones in ensuring corporate disclosure by listed companies include the Nairobi Securities Exchange Listing Manual, the Capital Markets (Securities), (Public Offers, Listing and Disclosures) Regulations 2002, the Capital Markets Guidelines on Corporate Governance Practices by Public Listed Companies in Kenya.

Publicly held companies are required to make annual reports to the Capital Markets Authority on their compliance and non-compliance with the Guidelines on corporate governance. Since 2004, the Capital Markets Authority has been posting compliance statistics in its annual reports. [226]

The Capital Markets Authority reviewed the compliance of listed companies with the various aspects of the existing regulatory framework including the Code of Corporate Governance Practices for Public Listed Companies in Kenya. Three firms failed to comply with the board

[223] These powers are reinforced under the Capital Markets Act under sections 11(3)(cc)(h)(i)(t)(u)(w),25A,34 and 34A. Section 25A gives the range of administrative actions that the Authority may take whereas section 34 creates offences and the applicable penalties.
[224] Supra note 10
[225] Development, U. N. Case study on corporate governance disclosures in Kenya Geneva: United Nations (2003)
[226] Every public listed company shall disclose, on an annual basis, in its annual report, a statement of the directors as to whether the company is complying with these guidelines on corporate governance with effect from the financial year ending during 2002, as prescribed under the Capital Markets (Securities) (Public Offers, Listing and Disclosures) Regulations, 2002.

composition requirements the balance between executive and independent, non-executive directors. Two listed firms failed to comply with the separation of roles between chairman and Chief Executive Officer. Seventeen (17) companies among fifty eight (58) listed at the Nairobi Securities Exchange failed to comply with the requirement to form a nomination committee. Three (3) firms did not comply with the recommended composition of the audit committee, and ten (10) listed firms did not disclose the specific details of its composition. Almost all firms did not comply with the requirement to establish a fixed term service contract of not more than five-year service contract for executive directors. [227]

Notably, the provisions on multiple directorships applicable to chairmen as well as the establishment of a company secretary certified by the Institute of Certified Public Secretaries of Kenya were complied with fully.

The Capital Markets Authority as part of its enforcement action[228] imposed a public reprimand and a financial penalty of Kshs.5,555.56 on Equity Investment bank Limited[229] for the late submission of management accounts for the quarter ending 31 March 2012.[230] Other Companies penalized by the Authority included Citidell Company Limited, Tsavo Securities Limited, Express Kenya Limited, Dry Associates limited, Africa Alliance Investment Bank Limited. [231]

Tsavo Securities failed to produce documents on several occasions as requested by the Authority and on 21 December 2012, former Managing Director, Mr. Fred Mweni was disqualified from

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[227] Capital Markets Steering Committee On Corporate Governance A Corporate Governance Blueprint For Kenya version 10 (a 2014

[228] Capital Markets Authority enforcement actions include: Levying financial penalties; Publishing findings of malfeasance by any person; Suspending or cancelling the listing of any securities; Disqualification from appointment as a director of a listed company; Give directions to any person which it has approved; and Doing all such other acts as may be incidental or conducive to the attainment of its objectives or the exercise of its powers under the Capital Markets Authority Act.

[229] Sections 11(3)(w),25A(1)(a)(vi) and 34A(1)(b) of the Capital markets Act

[230] Regulation 43 of the Capital Markets (Licensing Requirements)(General) Regulations 2002 which requires all licensees to submit to the Authority their management Accounts within fifteen(15) days of the end of each calendar quarter.

[231] Capital Markets Authority Annual Report 2013 http://www.cma.or.ke/index.php?option=com_docman&view=docman&Itemid=231 accessed on 15th April 2015

appointment and service as a Director in a listed company or firm licensed or approved by the Authority. [232]

In CMC Holdings Limited, the Authority[233] unanimously resolved to disqualify with immediate effect, some past and current directors from appointment as a director (s) of any listed company or licensed or approved person, including a securities exchange in the capital markets in Kenya.[234] Following the enforcement action taken by the Authority Mr. Muthoka, Mr. Kivai and Mr. Kiereini, being aggrieved by the decision of the Authority disqualifying them as directors filed separate suits in the courts[235] seeking to overturn the Authority's decision. However, following extensive discussions and deliberations between the Authority's legal representatives and Mr. Muthoka and Mr. Kivai's legal representatives the latter two parties filed a notice of withdrawal of the two judicial review matters. [236]

3.4.2 Role of the Nairobi Securities Exchange

NSE is primarily responsible for regulating members and the conduct of listed companies through its various rules and regulations. Of particular importance is its role in monitoring and enforcing continuing listing obligations, which are geared towards ensuring comprehensive and timely disclosure, particularly of material information pertaining to the performance of listed companies.[237]

Despite its role, up to 2007, the Nairobi Securities Exchange was limited in the manner of control it had over the market intermediaries. It could not control the makeup or structure of the board of directors or in the appointment process of top administrative posts. Consequently, the Nairobi Securities Exchange until 2007 had no punishment or sanction powers over the listed companies. They merely suggested on the best practices but had no real power to ensure that listed companies

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[232] Ibid pg 30

[233] Pursuant to section 25A (1) (c) (i) of the Capital Markets Act, the Board of the Capital Markets Authority in its meeting of 3rd August, 2012

[234] Mr. Martin Henry Forster; Mr. Jeremiah Gitau Kiereini; Mr. Charles Njonjo; Mr. Peter Muthoka; Mr. Richard Kemoli; Mr. Andrew Hamilton; Mr. Sobakchand Shah.

[235] Misc. Application 356 and 355 of 2012 respectively

[236] Supra note 233

[237] J Wairimu Corporate Governance Irregularities in Kenya's Financial Markets (2010) https://www.scribd.com/doc/31603577/Corporate-Governance-Irregularities-in-Kenya-s-Financial-Markets accessed on 5th August 2014

complied with the best practices of corporate governance. This created a gap for companies to compromise and it thus important to note that it was between this period that the major fraudulent activities by stockbrokerage firms occurred. During the 2007-08 budget speech, the government acknowledged the need to protect the integrity of the securities exchange and the small investors from unscrupulous market players. The Nairobi Securities Exchange is empowered to impose penalties.[238]

3.5 Conclusion

In this chapter I have discussed the corporate scandals in Kenya particularly in relation to Uchumi, Cooper Motors Corporation and the East African Portland Cement highlighting the weaknesses in their corporate governance systems. The chapter has also highlighted the legal framework of corporate governance in Kenya and the enforcement mechanisms in place.

This chapter reveals that corporate governance lapses in Kenya have led to governance scandals and "boardroom wars" in several listed companies. Much of the legal framework in Kenya particularly the current Companies Act, which is a replication of the UK Companies Act, 1948 and is outdated and should be revised to accommodate dynamics in the corporate sector.

Although significant progress has been made in strengthening corporate governance in Kenya, through the Guidelines on Corporate Governance Practices for Public Listed Companies in Kenya, a lot more needs to be done. This should include amending the present laws including the Companies Act and seeking reference to precedent decrees which provide a direction for exemplary corporate governance systems.

[238] Ibid

CHAPTER FOUR: CONCLUSION AND RECOMMENDATIONS

4.1 Summary of findings

This study sought to make a case for the implementation of effective laws, rules, principles and guidelines of corporate governance as opposed to the current legislation on corporate governance which is inadequate for achieving effective corporate governance and reducing the number of corporate failures in Kenya.

The study sought to answer five questions which include; the legal framework of corporate governance in Kenya, the legal framework of corporate governance in United Kingdom (UK), United States of America (USA) and South Africa, the obligations that states have and to what extent has Kenya met those obligations, what can be done in Kenya to curb poor corporate governance practices and to what extent is the legal framework on corporate governance effective.

The study revealed that in the USA the collapse of Enron, WorldCom, and Tyco International led to corporate governance reforms including the enactment of the Sarbanes –Oxley Act (SOX) in 2002. In the UK, corporate governance involves a discretionary approach. Listed companies conform to voluntary codes of principle and best practice then report that they have complied or explain why they have not. However, in South Africa, unlike most corporate governance codes such as Sarbanes-Oxley, its code is non-legislative, and is based on principles and practices. King III report opted for an 'apply or explain' governance framework. Where the board believes it to be in the best interests of the company, it can adopt a practice different from that recommended in King III**,** but must explain it. The framework recommended by King III is principles-based and there is no 'one size fits all' solution. Companies are encouraged to tailor the principles of the Code as appropriate to the size, nature and complexity of their organization.[239]

A review of the Kenyan case in chapter 3 reveals several issues. It establishes that the Capital Markets Authority (CMA) guidelines on corporate governance practices by public listed companies replicated the Combined Code of the United Kingdom without any serious attempt to

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[239] African Development Bank, African Development Report (2011) pg 143 http://www.afdb.org/fileadmin/uploads/afdb/Documents/Publications/African%20Development%20Report%202011%20-%20Chapter%207-Corporate%20Governance.pdf

domesticate them. Kenya has also through the Centre for Corporate Governance developed a sample code of best practice which was adopted in 2002. This code has been borrowed from other codes with little thought being given to the underlying conditions of the market in which this code is to be enforced.

The ineffectiveness of the principles and guidelines of corporate governance in Kenya is attributable to the weakness of the underlying legal framework.

4.2 Conclusions

Kenya should develop a practical code that includes internationally accepted principles and standards while at the same time, taking into consideration the special circumstances that Kenyan corporations face. This should be done while amending the present laws and seeking reference to precedent decrees which provide a direction for exemplary corporate governance systems.

4.3 Challenges to the legislative framework of corporate governance in Kenya

4.3.1 Weak legislation

The Companies Act (Chapter 486 of the Laws of Kenya) which replicates the United Kingdom's Companies Act 1948, is no longer in consonance with local circumstances.

The Guidelines of Corporate Governance Practices for public listed companies in Kenya is also as a result of a combination of ideas from corporate governance codes from different jurisdictions. Kenya has also through the centre for corporate governance developed a sample code of best practice developed and adopted in the year 2002. This code of corporate governance has been borrowed from presumably more developed countries. It does not adequately serve the interests of public listed companies in Kenya.

The corporate governance codes and the companies Act have to complement each other, in terms of the objective that is to be achieved. Section 1.4 of the CMA Guidelines provides that the guidelines are meant to promote the standards of self-regulation so as to bring the level of governance in line with international trends. Self-regulation needs to be backed up by strong legislation hence the need to amend the Companies Act.

4.3.2 Appointment of directors

Section 188 of the Companies Act which deals with the appointment of directors, provides that if a person who has been declared bankrupt, acts as a director of a company without leave of court, he shall be liable to imprisonment for a term not exceeding two years or a fine not exceeding Kshs. 10,000 or both. Further, subsection 2 of the same section states that for leave to be granted the bankrupt individual must show that he may safely be involved in the management of companies.

It therefore implies that a bankrupt who has not been discharged is not prohibited from acting as a company director with leave of the court. Bankrupt individuals need to be prevented from starting businesses and raising credit using a limited liability company. The exploitation of the limited liability doctrine was a key feature of the Goldenberg scandal and the Anglo- leasing scandal where companies were used as instruments of fraud to raise credit and transfer misappropriated funds.

Section 189[240] of the Companies Act offers a loophole for persons guilty of fraudulent acts to act as a director at the discretion of court and cannot be barred from acting as such for on the grounds of those previous fraudulent acts after a period of five (5) years.

4.3.3 Duties of directors

The Companies Act does not codify the duty of directors which has led to a reliance on common law and other precedent to establish these duties.

Even those directors who spend time trying to understand the internal workings of a firm are limited by their lack of expertise on many issues. The matter of a nomination committee as provided for in the governance codes has not been followed to the letter. This results in the recruitment of directors who do not fully comprehend the nature of the company, let alone the role which they have been assigned.

[240] Section 189(1) empowers the court to make an order restraining a person from being appointed, or act as a company's director for a period not exceeding 5 years if: -
(a) The person is convicted of any offence in connection with the promotion, formation or management of the company, or (b) in course of winding up, it appears that the person had been guilty of fraudulent trading.

4.3.4 Liability of Directors

Section 318 of the Companies Act absolves directors' liability by providing that directors can be exempted from liability for offences that are discovered during liquidation if they had no intention to defraud the company, or to conceal the company's state of affairs. This 'intention to defraud' is quite difficult to show.

The penalties within the Penal Code like those in the Companies Act effectively exonerate directors from liability by requiring shareholders to prove the director's dishonest intention, which is difficult. In the USA, an attorney can bring proceedings on behalf of minority shareholders without the consent of the directors of the company while an advocate in Kenya cannot bring proceedings against a company on behalf of the shareholder without the authority of the board. Consequently, these sections give company directors no incentive to ensure that they exercise due diligence in the performance of their duties, thus diluting the Act's resolve to enforce this aspect. It is also apparent that the Act offers a platform of subjective standard of liability.

4.4 Common corporate governance issues

4.4.1 Breach of Fiduciary duties

Board members are expected to act in good faith and in the best interest of the company. In East African Portland Cement Company (EAPCC) case, the board members were acting in the interest of the groups they represented and not in the interest of the company. The ministers and senior government officials did not act in the interest of the country in the Anglo Leasing case. The then company secretary of EAPCC reported that at an annual general meeting a vote by way of poll had not been called for and yet the evidence that emerged was that the same had been requested and been overruled. [241]

In Cooper Motors Corporation (H) Ltd (CMCH) case, the board members were accused of operating offshore arrangements contrary to fiduciary duties of directors under paragraph 3.1.1 of the guidelines. The offshore account and the over invoicing to the Company had been done at 1.5% and 2% by a financing house, namely, Sojitz. According to the Directors, the accounts were opened offshore so as to 'manage' the exchange control rules. The directors and top management

[241] David Herbling CMA moves to probe Portland after chaotic AGM 'Business Daily' 18th December 2013

benefitted from the Trust and no tax was paid. Also argued that the lending rate at that time for Kenya and Uganda were very high and the 'overseas funds' were loaned at a lower rate of interest. The issues here were that the Directors were aware of the existence of the offshore arrangements, were intimately involved in the operations of those offshore arrangements; and benefited from the offshore arrangements to the detriment of the CMCH and its shareholders.[242]

The near collapse of Uchumi Supermarkets Limited was mainly attributed to poor oversight at the board level which led to reduced scrutiny of management decisions including sale of its prime assets, investments in property and an ambitious expansion plan. The directors and executives of the company failed to act in the best interests of the company and they were charged with conspiracy to defraud the company by selling off the building that houses its Aga Khan Walk branch for Kshs. 147 million without valuation.[243]

Access Kenya Limited, which was owned by a father and two sons,[244] went public in 2007. The owners retained 26% of the company‘s shares and remained the chairman of the board of directors, managing director and executive director respectively. To consolidate the family‘s control of the board, the family appointed a fourth director who was a partner in a law firm where the chairman of the board was a senior partner for over thirty years. The company had three other directors who in early 2010 are reported to have questioned how two tenders were awarded without involving all members of the board. The three were forced to resign due to the lack of transparency in the company's financial matters and weak management practices in relation to fibre optic deal.[245]

Investigations by Deloitte, an auditing firm and Runji Partners, an engineering firm commissioned by the company vindicated the three directors that the tenders had been awarded irregularly and the company lost over Kshs. 300 million ($ 3.75 million). Fearing that shareholders would demand answers on the tender and loss to the company, the board of directors postponed the company‘s annual general meeting scheduled for May 31st to August 31st 2010. Some shareholders petitioned the CMA on the domination of the Somen family of the board. This scandal

[242] Petition no 371 of 2012 Jeremiah Gitau Kiereini v Capital Markets Authority & another [2013] eKLR
[243] Uchumi picks ex-Telkom executive as board chairman BUSINESS DAILY, October 17, 2012.
[244] Michael Somen, the chairman, Jonathan Somen (managing director), David Somen (executive director)
[245] Michael Omondi, Why Access Kenya‘s AGM was Suspended, BUSINESS DAILY, May 14, 2010, at 20.

exemplifies the typical challenge where the majority dominates the board of directors and is inclined on gleaning private benefits of control. [246]

4.4.2 Non-Disclosure

The CMA Guideline on corporate governance provides that institutional investors operating under the jurisdiction of CMA should be transparent, honest and exercise fair practices in their dealings. CMC directors failed to explain areas of non-compliance in the annual report of the company. [247]

4.4.3 Breach of duty to exercise reasonable care, skill and diligence

CMC adopted a risky business model for the Company of borrowing to lend and failed to implement an asset/liability management process to monitor, manage and hedge all such risks associated with the activity of borrowing to lend contrary to the Guidelines. The Government through its ministers and high ranking officials entered into contracts with companies without undertaking a due diligence on the structure and existence of the companies involved.[248]

4.4.4 Failure to exercise effective oversight over the management of the Company

In the CMC case, there was a weak internal audit function and weak internal controls on the operations of the Company contrary to the Guidelines. In the Anglo Leasing case, the Attorney General was not involved in negotiations for the contracts as required by the Financial Regulations. The Attorney General's failure to make any efforts to demand his involvement as the chief legal government advisor in the two (2) specific contracts given to Anglo Leasing and Finance Limited.

4.4.5 Appointment of a Company secretary who was not qualified

In the CMC Holdings Limited (CMCH) case board members provided false information to the public on the status of the Company secretary contrary to regulation F.06 of the 5th Schedule of the Capital Markets (Securities) (Public offers, Listing and Disclosure) Regulations 2002 and Section 34 (1) (b) of the Capital Market Act. In the hearings, the directors claimed that they

[246] Ibid.
[247] Supra note 244
[248] Supra note 244

were not aware of the role of the company secretary other than the administrative function and minute writing. [249]

4.4.6 Signing off accounts not prepared in compliance with International Financial Reporting Standards (IFRS)

Between 2009 and 2010 the CMC Holdings Limited (CMCH) accounts were prepared contrary to Article 2.4.1 of the Guidelines. Specific breach of IFRS were that the interest to be earned were not accounted for in the financial statements, the method of impairing debtors from carrying amount recoverable and mis-clarification of trade payables.

The East African Portland Cement Company (EAPCC) annual report, 2012 stated that it had discovered theft by its employees of cement worth Kshs. 181 million covering 2012 and 2013 financial years, prompting a review of its books by National Audit Office and its agent Ernst & Young.[250]

4.4.7 Appointment of a non-independent chairman

The CMC Holdings Limited (CMCH) Board appointed a non independent Chairman in breach of Guidelines 17, which stipulate that the chairman of a listed Company should be independent and non-executive, as he was the majority supplier of CMCH through Andy Freight. In EAPCC, there was no formal and transparent procedure in appointment of board members. Larfarge's control of the Portland's board was greatly eroded when the board's chairman Mark ole Karbolo was replaced by former CMCH chief executive officer Bill Lay. Mr Karbolo was an appointee of the government but the government had claimed he sided with Larfarge when making the decision. He was also blamed for blocking the government's proposal of Mr. Lay as a director during the Annual General Meeting (AGM) in favour of Larfarge's Mr Tresarrieu.[251]

4.4.8 Non Compliance with Laws and Regulations

The Capital Market Authority Guidelines of Corporate Governance Practices for Listed Companies provides that the Board should ensure the Company complies with all applicable laws and Regulations in line with accepted national and international standards, as well as its internal policies. In EAPCC case board members breached provisions of the articles of associations

[249] Supra note 244
[250] David Herbling Portland Cement theft prompts review of books 'Business Daily' 5th January 2014
[251] Galgallo Fayo French group loses bid to firm grip on Portland 'Business Daily' 12th March 2014.

and the Company Act. Sec 137 of the Companies Act provides for the right to demand a poll on any issue. The representative of Government and NSSF requested each resolution to be put to vote but the chairman overruled this request. The chairman of EAPCC in disregard to the requirements of Articles 110 of the Articles of Association proceeded to file suit on behalf of the company when he knew that a proper resolution signed by majority of the shareholders sanctioning filing of suit had not been passed. This fact was captured in the court's ruling on the preliminary objection where the court held that[252].

"The upshot of these considerations is that in the absence of a board resolution sanctioning the commencement of this action by the company, the company is not before the court at all. For that reason, the preliminary objection succeeds and the action must be struck out with costs to be borne by the plaintiff"

In CMC Holdings Limited (CMCH) case, the directors breached the Capital Markets (Take-over and Mergers) Regulations, 2002 by holding more than 25% of the shares of a listed Company without making an offer. Under the regulation, the person is deemed to have effective control and as such they ought to have applied to CMA for an exception.[253]

4.4.9 Abuse of Office

The directors of any board have a duty to act within the powers granted unto them and to the best interest of the company. The Chairman of EAPCC acted in excess of his powers by filing a suit to challenging the appointment of the new chairman (Bill Lay). This move was not made in the interest of the company but for his own interest because the appointment affected him. Mumbi J[254] held that the president has powers in appointing a board chair or director of a state corporation or revoking both, Mr Ole Karbolo clearly intended to protect his personal interests which he would have a better forum to discuss his removal from office.

[252] Petition NO. 600 of 2013, East African Portland Cement Company Ltd (EAPCC) v The Capital Markets Authority Ltd & 5 others
[253] Regulation 3 of the Capital Markets (Take-Overs and Mergers) Regulations, 2002.
[254] Supra note 254

4.5 Recommendations

In order to enhance corporate governance and reduce the number of corporate failures in Kenya the following steps need to be taken.

4.5.1 Legislative framework

Kenya ought to restrict foreign influences upon its legal system to those rules of corporate governance which have proved successful in other jurisdictions with similar market conditions and to be flexible enough to dismantle those legal traditions based on inappropriate market models. Adopting foreign corporate governance practice should be done with caution even in cases where market conditions are similar because not only are the policies in these countries likely to differ from those in Kenya but the size and nature of the business transacted in these countries and the people that company law is seeking to protect may have different standards of sophistication and education.[255]

4.5.2 Effective legislation

The existing voluntary codes remain visionary and their provisions are yet to be implemented fully owing to a non-supportive legislative framework. Also, no attempt has been made to align the guidelines with the underlying legal framework.

Commentators observes that in reality the effectiveness of these codes is largely dependent on the underlying legal and regulatory framework and which is inadequate in Kenya.[256]

Countries such as the United Kingdom and South Africa have continuously updated and improved their corporate governance codes to ensure that the provisions are dynamic in enhancing good corporate governance practices. Unfortunately, no improvements have been made to the Kenyan code since inception.

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[255] Supra note 15 pp 4-5

[256] Supra note 14 http://www.ijhssnet.com/journals/Vol_3_No_6_Special_Issue_March_2013/11.pdf accessed 15th April 2015

More importantly, the guidelines developed by various institutions are non-statutory, non-mandatory, and generally unenforceable. Implementation of good corporate governance is largely dependent on the goodwill of various market players.

4.5.3 Directors' duties

The Companies Act codifies neither the director' duties of care, skill and diligence nor the fiduciary duties. The duties of directors in Kenya are governed by the English common law as modified by the doctrines of equity. The principles governing these duties are uncodified and arguably inadequate to regulate directors' behavior.

The absence of codified statutory duties of care and skill or equitable duties implies that there are no commensurate penalties for breach prescribed in statute and this could encourage malfeasance by company directors. More so, the penalties prescribed under the Companies Act for directors' breach of duty are too lenient. For example, the Act provides that a director who fails to disclose any interests he has in contracts made with the company shall be liable to a fine not exceeding Kenya Shillings Two Thousand.[257]

However, the Companies Bill, 2015 proposes codification of the duties of directors. The duties proposed include the duty to act within powers, duty to promote the success of the company, duty to exercise independent judgment, duty to exercise reasonable care, skill and diligence, duty to avoid conflicts of interest, duty not to accept benefits from third parties and duty to declare interest in existing transaction or arrangement. [258]

4.5.4 Directors' liability

There is a need to review laws on director liability to reflect a dual standard of liability with both objective and subjective elements of liability. By adopting a dual standard of liability for company directors, Kenya would greatly improve its competitiveness as an objective standard would be incorporated into the law and therefore provide an atmosphere in which good corporate governance

[257] Section 200 of the Companies Act, 1962.
[258] Clauses 103- 109 of the Companies Bill, 2015.

can thrive. Incorporating an objective standard into the law affecting director liability would give directors an incentive to take more responsibility for their duties and act in the interests of shareholders.

The dual test for director liability under the duty of care and skill has recently been adopted in England. Section 174(2) of the United Kingdom's Companies Act 2006 provides that a director: "… must display the care, skill and diligence that would be exercised by a reasonably diligent person with both the general knowledge, skill and experience that may reasonably be expected of a person carrying out the same functions as the director in relation to that company and the general knowledge and skill that the director actually has." This test obviates the defence of ignorance. This is particularly because s.174 of the UK Companies Act requires directors to act with reasonable care, skill and diligence. Adopting a dual standard of care and skill in Kenya would promote entrepreneurship while not leaving room for negligence resulting from ignorance or inexperience in running public held companies.[259]

4.5.5 Audit committee

The Companies Act should recognize and institutionalize audit committees. An audit committee that adheres to the principles of corporate governance is important not only because it can boast transparency and accountability of the company's funds, but because its absence may lead to failure in achieving its objectives due to weakness within its systems which can be avoided by the establishment of an audit committee. The committee is mandated to set up internal controls which can forestall failures from happening such as fraud or embezzlement, can limit the potential effect of such failures, identify when a failure has occurred and employ corrective measures. In addition, it advices the company against reckless business strategies which could contribute to its collapse.

4.5.6 Company secretary

Importantly, a company must have a secretary. Although the company secretary's office is separated from directors and other officers of the company, the holder of the office is a director for purposes of section 2 of the Act. King III Code, which states that "the board of directors should

[259] Ibid pg 5

be assisted by a company secretary who is competent, suitably qualified and experienced"[260] This Code adds that "...A company secretary is in a unique position to fulfill an important role in corporate governance. They are not a member of the board and so they do not have direct responsibilities for corporate governance and accountability to shareholders…but they are aware of what happens in the board meetings and they can advise and assist not only the chairman, but the board as a whole."[261]

4.5.7 Corporate code of ethics for directors

Codes of ethics promote the values of integrity, honesty, efficiency, effectiveness and impartiality of officials when exercising discretion or when acting in public interest. It also sets the tone for the ethical behaviour of the corporation and this in turn ensures that a corporation adheres to good corporate governance practices.

In Kenya, company directors are not governed by a code of ethics. Lack of codes of standards to regulate conduct of directors often leads to poor corporate governance. Lack of accountability, partiality, inefficiency, ineffectiveness and corruption occupy the vacant space.

The Sarbanes-Oxley Act[262] requires public companies to disclose whether they have codes of ethics and also to disclose any waivers of those codes for certain members of senior management. Legislation should require publicly listed companies to develop and operationalize a code of ethics so as to promote good corporate governance.

4.5.8 Director training

Induction of new board members and continuous training of directors is not a statutory requirement in Kenya and is therefore not mandatory. As such, many directors are unaware of their duties to the company.

[260] Principle 2.21 of King III report on corporate governance in South Africa (2009)
[261] Ibid
[262] Section 406 of the Sarbanes Oxley Act, 2002

Good corporate governance practices dictate that directors should undergo orientation and continuous training to ensure that they are informed of their roles and responsibilities as directors. Board procedures and practice and to ensure they are abreast with the current corporate environment and stakeholder needs.

The Companies Act should therefore be amended to provide for mandatory induction of directors as well as continuous training and enhancement of capacity to ensure they understand and appreciate their roles and responsibilities as company directors.

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