UNIVERSITY OF NAIROBI

SCHOOL OF LAW

TACKLING THE PROBLEM OF CORPORATE FRAUD IN THE KENYAN CORPORATIONS THROUGH THE LENS OF CORPORATE GOVERNANCE

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DECLARATION

I declare that "Tackling the Problem of Corporate Fraud in the Kenyan Corporations through the Lens of Corporate Governance" is my original work that 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. Constance Gikonyo)

DEDICATION

I dedicate this thesis to my mother, Helen Mutonyi and my siblings who have stood with me throughout my educational journey.

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ABSTRACT

The thesis examines the issue of corporate fraud in the Kenyan public and private firms. The thesis notes that the country has been grappling with a series of corporate frauds that has led to many firms to fail such as Uchumi Limited, Chase Bank Limited and Nakumatt Limited among others. The rising cases of corporate fraud have been largely attributed to weak legal, regulatory and policy framework. Dishonest company directors, employees and other unscrupulous businessmen have been exploiting the gaps in the law to perpetrate illegal acts leading to the loss of investor capital.

Further, the study notes that rising cases of corporate fraud in Kenya is attributed to weak laws that govern the issue hence there is a need for reform. It notes that there have been regulatory challenges in terms of enforcing good corporate governance practices in corporations due to various institutional challenges. Also, there is a challenge in enforcing the code of corporate governed hence there is a need to ensure greater compliance and also reporting a mechanism by corporations.

Lastly, the research explores the lessons that Kenya can borrow from the United Kingdom and also South Africa on the ways in which the laws can be improved. The study noted that the two countries offer valuable lessons that Kenya can use to improve its law, regulatory enforcement and also policy approaches. The recommendations offered by the study are important in addressing the problem of corporate fraud which shall help to minimize the rising cases of fraud.

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CHAPTER ONE
INTRODUCTION AND GENERAL OVERVIEW OF THE WORK

1.0 INTRODUCTION/BACKGROUND TO THE STUDY

Corporate fraud is a broad term that encompasses illegal activities done by either the directors or also the company employees. It may refer to theft of the company assets, payroll fraud, and embezzlement of company funds, corruption and related activities. [1] On the other hand, corporate governance is a term that is used to imply the different rules and practices that have been established to guide a firm. In a broader sense, it entails balancing the rights of the stakeholders in a company such as the management, shareholders, customers, suppliers, financiers, community and the government. Further, it entails protocols and institutional systems that ensure sound ethics, transparency, and accountability.[2] Companies need to adhere to good corporate practices to promote good corporate governance.

There are various corporate governance attributes that can be applied in dealing with the issue of corporate fraud in Kenya. Most of the attributes are encapsulated in various laws such as the Constitution of Kenya, the Companies Act 2015, and the Code of Conduct for the Issuers of Issuers of Security to the Public, Mwongozo Code for State Corporations and other relevant enabling legislations. These attributes when applied can be used to address the issue of fraud. Other than the corporate governance principles, other legal framework can be applied in order to address the issues such as the Penal Code and other applicable legislations.

The principle of transparency and disclosure can assist in dealing with the issue of corporate fraud. Most of the scandals that have occurred in the country are as a result of non-adherence to the said rules. The second important principle is the principle of accountability that mandates all the corporations to be accountable. Lack of accountability has led to collapse of firms such as Uchumi and Nakumatt. The third principle is integrity, the board of directors and also the management should be persons of integrity and should act fairly. The other corporate governance pillars include; responsibility, efficiency and effectiveness. In addition, the code states that the appointment to the board should a transparent process; the board of directors needs to hold regular meeting and also

[1] Alan Calder, *Corporate Governance* (Kogan Page 2008).
[2] Ibid

they should in calculates good corporate culture to the company, separation of the role of CEO and also the chair among others.

The corporate failures that have been witnessed in Kenya have been mainly due to corporate fraud. In this regard, it is important to review the legal, institutional and policy framework that regulate the operations of the companies. The recent failures of the Mumias Sugar Company Limited, Nzoia Sugar Company Limited, Nakumatt Limited, Uchumi Limited Company Limited, to name but a few have heightened the public discourse on the need to analyze the legal, institutional framework governing the operations of companies in Kenya. The fraudulent activities that have led to the collapse of the companies include falsifying the financial statements and theft of company assets. . Even though corporate fraud is a major issue affecting the success of many businesses in Kenya, there has been little literature dedicated to reviewing and addressing the root causes of the issue and exploring various ways in which the issues can be addressed. The Companies Act, 2015 and regulations thereto has not been able to curtail these vices. To date, there are few reported cases of directors or public officers who have been held responsible for violating the law in terms of management of companies.

In the case of Uchumi Company Limited, the board of directors and the management operated in disregard of the laid down procedures. There was evidence of corruption by some employees and also the Board of Directors. Further, there were fraudulent suppliers that colluded with company officials to fleece the company.[3] Moreover, there was flawed rights issue that made the shareholders to lose close to 875 million. [4] On the other hand, in the case of Mumias Sugar there was evidence that the directors and top management engaged in fraudulent dealings that made the company to collapse. [5] In addition, in the case of Chase Bank the directors took huge amount of loans despite the fact that the company was making losses. For instance, the Chase Bank director lent himself close to 7 billion. [6]This was in blatant disregard of the laid down procedures and also good corporate

[3] Business Daily 'Uchumi Blames Employees, Fake Suppliers For Collapse' (*Business Daily*, 2019) <https://www.businessdailyafrica.com/news/539546-5206888-4ssyy8z/index.html> accessed 22 October 2019.
[4]Business Daily'Ex-Uchumi Directors Freed In Share Issue Fraud Case' (*Business Daily*, 2019) <https://www.businessdailyafrica.com/corporate/companies/Ex-Uchumi-directors-freed-share-issue-fraud-case/4003102-4273154-10l8t7mz/index.html> accessed 22 October 2019.
[5] Daily Nation 'How Mumias Bosses Brought Firm To Its Knees' (*Daily Nation*, 2019) <https://www.nation.co.ke/news/How-Mumias-bosses-brought-firm-to-its-knees/1056-2627206-6rm1tpz/index.html> accessed 22 October 2019.
[6]Business Daily, 'Chase Bank Director Borrowed Sh7.9 Billion Without Security' (*Business Daily*, 2019) <https://www.businessdailyafrica.com/markets/Chase-Bank-director-borrowed-Sh7-9bn-without-security/539552-

governance guidelines.[7] These among other issues exemplify how the Kenyan firms collapsed as regard of weak corporate governance practices.

A critical review of the relevant legislation, institutional framework, and implementation mechanism are important in understanding how the issue of corporate fraud can be minimized. Indeed, the investors and the public have the right to be protected against negligent and corrupt directors who breach the law. The constitution of Kenya under Article 10 states that the national values shall include integrity, transparency and accountability. Also, the Constitution recognizes the concept of ownership of property and states that a person has the right to acquire property either individually or in a group ofany description and that right cannot be deprived arbitrarily either by state or other individuals Further, the Companies Act has elaborate provisions on good corporate governance and mandates the directors to ensure they adhere to good corporate practices. Therefore it is necessary that the laws on corporate fraud should be re-looked including the institutional and implementation framework.[8]

1.1 STATEMENT OF THE PROBLEM

The problem sought to be addressed in this study is how weak legal, institutional and implementation challenges linked to corporate governance have led to fraud. The corporate frauds have been due to corporate governance lapses. Studies from comparative jurisdictions reveal that a solid legal and regulatory framework is the bedrock of good management of firms. The CMA has offered a good guideline on corporate governance based on established jurisdiction, but it has been unable to implement in the Kenyan legal system effectively. The Companies Act 2015 has domesticated various guidelines on sound management of corporations but since the Act came in place the issue has persisteda case in point is the collapse of Nakumatt Limited, the collapse of the Imperial Banks among others. .

1.2 JUSTIFICATION OF THE STUDY

The findings of this research are justified since it will enable the Government, companies and the Capital Market Authority to understand the gaps in the law and the various ways in which the issue of corporate fraud can be addressed. The study will illuminate the need to strengthen the existing

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3150510-wves4l/index.html> accessed 22 October 2019

[7]The Star 'Revealed: How Insiders' Loans Fraud Sank Chase Bank' (*The Star*, 2019) <https://www.the-star.co.ke/news/2019-02-18-revealed-how-insiders-loans-fraud-sank-chase-bank/> accessed 22 October 2019

[8] Ibid

framework. The thesis is also important to the private sector by providing recommendations on implementation of internal processes such as the whistleblowers to prevent corporate fraud.

1.3 OBJECTIVES OF THE STUDY

The general objective of the study is to examine how the weak legal, regulatory and enforcement mechanism has perpetuated the culture of corporate fraud in Kenya

1. To examine the existing legal, regulatory and corporate governance framework on corporate fraud in Kenya.
2. To examine the various corporate governance mechanisms and their efficacy in addressing the corporate fraud.
3. To explore the various ways in which the Kenyan laws can be improved to curb corporate fraud.

1.4 LITERATURE REVIEW

1.4.1 INTRODUCTION

The problem of corporate fraud is a major issue that has discussed by various authors across the globe giving various perspectives. It is a major problem that has led to the collapse of big corporations in the western world and also in Kenya and hence there is a need to highlight the gaps in the law. This research is aimed at filling the gaps in the law by coming up with proper policies.

1.4.2 CORPORATE FRAUD AS MAJOR IMPEDIMENT TO SUCCESS OF KENYAN FIRMS

Corporate governance is an emerging discipline in many of the African countries. Mulili and Wong studied corporate governance and its challenges in Kenya and used the case study of the Kenyan Universities. [9]They posit that the corporate governance in Kenya and other African countries differ in various ways. They state that it's important that the African develop their corporate governance code that takes into considerations their unique political, cultural and technological conditions. This research supports this study on the need to develop principles of the code of ethics that would

[9] Benjamin Mwanzia Mulili and Peter Wong, 'Corporate Governance Practices In Developing Countries: The Case For Kenya' (2011) 2 International Journal of Business Administration. 14

address the unique situation of the Kenyan. This study would fill the gaps by proposing various ways in which a code of ethics can be developed.

According to Ng'ang'a and Jebiwott [10]there have been massive corruption and fraud in many firms in Kenya especially in the public sector entities which have cost the investor great losses. For example, they note that the country loses approximately 4 billion annually on fraud in Kenya. They opine that the public sector has been worst hit by the issue of fraud which has resulted to the poor performance of many firms and they further avers that the problem is as a result of 'porous financial systems", "poor fraud detection" including the prevention and mitigation aspects. This study is mainly conducted from a business perspective, and hence there is a need to explore the effectiveness of the Kenyan laws in addressing the issue of corporate fraud. This study is relevant to my study on the premises that there is a need to come up with tough laws on fraud deterrence. The gaps that would seek to fill are to what extent the Kenyan laws can be used to address the gaps.

Further, they are categorical that an enormous amount of time has been used to formulate corporate governance codes, training the staff on the importance of adhering to this code and implementing the necessary internal control measures. However, there have been some dishonest and intelligent people who normally find ways of manipulating the system and gain access to the firm's assets and resources. There isvarious economic ramifications of fraud on the firm's performance such as increasing the customer inconvenience, loss of opportunity and it may lead to the collapse of the firm. [11]

Further, Kariuki[12]argue that the good corporate governance practices coupled with the fraud detection mechanism can assist the corporation in handling issues to do with fraud. Further, the study explored the role of internal control measures in preventing crime. The study was based on eight deposit-taking microfinance companies in Kenya. This study is relevant to this research in the sense that it addresses the role of good corporate governance in preventing fraud. The argument differs from this study in the sense that it will explore the issue from a legal stand-point and analyze

[10] Gladys Kiprono and Peter Ng'ang'a, 'Fraud Management Practices And Financial Performance Of Kenya Ports Authority' (2019) 3 International Academic Journal of Economics and Finance 242
[11] Ibid
[12]Nancy Kariuki, 'Effect Of Credit Risk Management Practices On Financial Performance Of Deposit Taking Savings And Credit Cooperatives In Kenya' (2017) 19 IOSR Journal of Business and Management. 63

how the laws can be used to ensure that fraud is minimized at companies. The gap in the requirement that the paper will seek to examine is the role of the law in addressing corporate fraud.

Similarly, Otieno, Chelule, and Bor [13]in their study examined the issue of fraud and how it affects the operations of the County Government of Nairobi. In the research carried out at the County Government of Nairobi, noted that management issues and weak control measures affect the operation of the county. The study is essential in the sense that it shows how that poor corporate governance practices can negatively impact the services of a firm. The study is different from my research in the sense that whereas this study analyzes the County Government, my study will be based on Kenyan corporations. The gap in the law is how corporate governance rules can be used to prevent fraud.

Further, Gitau and Njenga,[14]in their sought to investigate effect of fraud in the performance of commercial banks in Kenya with a particular focus in top tier firms located in Nakuru. The study concluded that poor corporate governance impacts the general performance of public companies. This study shows that weak corporate governance may lead to corporate failures. My study differs with this research in the sense that it will analyze how weak corporate governance practices may lead to poor performance. The gap in the law is whether weak corporate practices affect the performance of companies

1.4.3 CORPORATE FAILURES IN OTHER JURISDICTIONS

In another study conducted in Nigeria, Osemeke and Osemeke[15]argue that culture plays a big role in corporate frauds that have occurred in Nigeria. The study identified the following to be a major issue; there have been constant abuse of power by the management, poor recruitment practices that have been employed among others. This study will borrow from the findings of Osemeke research paper and argue that culture plays an important role, whereas this paper has focused on Nigeria. This study will focus on Kenya. The knowledge gap that will be filled is to examine the extent to which culture impacts corporate practices in Kenya.

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[13]Fredrick Otieno, Esther Chelule and Erick Bor, 'Challenges Faced By Security Personnel In Fraud Detection In The County Government Of Nairobi, Kenya' (2014) 19 IOSR Journal of Humanities and Social Science. 48

[14] Gitau Everline and Njenga Samson, "The Effects Of Financial Fraud And Liquidity On Financial Performance Of Commercial Banks In Kenya "(2016) IV International Journal of Economics , Commerce and Management 142

[15]Nobert Osemeke and Louis Osemeke, 'The Effect Of Culture On Corporate Governance Practices In Nigeria' (2017) 14 International Journal of Disclosure and Governance. 318

Soltani [16] in her study evaluates the issue of corporate failures in America by analyzing the case of Enron, WorldCom, and HealthSouth. The author states that corporate scandals were due to poor corporate governance practices; for instance, they list fraudulent financial reporting, ownership structure and management issues as the main cause of scandals. The study is relevant in with research in the sense that this study will be using the examples of companies used in analyzing explaining how corporate fraud is a major issue. The research differs from this research because this paper will be focusing on the Kenyan situation. The knowledge gap that the research would seek to fill is to examine the legal dimension in addressing the issue of corporate fraud.

Sailaja MV and Begum MSA [17]in their article examined the issue of corporate fraud in the emerging economies. He summarized the major types of fraud to include technology frauds, employee frauds, banking frauds, and accounting frauds. They observe that the main reason why frauds have existed is due to poor corporate governance culture. The study supports this study in the sense that it explains various types of frauds and how they can be prevented. The information is important in coming up with relevant laws in curbing corporate frauds. The research has not explored the legal dimension in curbing corporate crime.

Henning Peter [18] examined the question of why it is difficult for the USA government and other state agencies to prosecute executives who are found to have committed corporate fraud. He highlights various cases of white-collar crimes that the US governments have been unable to address as of 2017. Further, he examined the effectiveness of the U.S. Foreign Corrupt Practices Act. The article supports this research in the sense that in Kenya, the government and capital markets authority have been unable to deal with corrupts directors, to date, there has been no conviction of those accused of defrauding the companies. This research examines the issue of institutional failure. It would examine the role of the Kenyan regulator in curbing corporate fraud and propose ways in which the regulator can be strengthened. Also, Baxter Lawrence[19] agrees that the regulators have been unable to regulate banks; leading to frauds like in the case Barings bank in the UK. This

[16]Bahram Soltani, 'The Anatomy Of Corporate Fraud: A Comparative Analysis Of High Profile American And European Corporate Scandals' (2013) 120 Journal of Business Ethics. 251
[17] Ponduri. S.B. V. Sailaja and Syeda Amina Begum, 'Corporate Governance - Emerging Economies Fraud And Fraud Prevention' (2014) 16 IOSR Journal of Business and Management. 1
[18] Henning Peter, "Why It Is Getting Harder To Prosecute Executives For Corporate Misconduct"(2017) 41 Vermont Law Review 503
[19] Baxter Lawrence, "Adaptive Financial Regulation and Regtech: a Concept Article on Realistic Protection for Victims of Bank Failures" [2016] Duke Law Journal 567

argument supports this study on the need for regulators to curb bank frauds since they have a major role to play. Thus, this study will explore how the Director of Public prosecutor can work with the Capital Markets Authority to ensure that corrupts directors are charged.

Sharina and Authman [20]in their article postulate that the Board of Directors' frequent meetings can be an effective deterrent in preventing corporate fraud. In their study which was based in Malaysia, concluded that frequent board meeting could help the company in ensuring that it adheres to good corporate governance. This article supports this study since it provides various mechanisms in which the vice can be prevented in Kenya by recommending that the board of directors in Kenya should be holding regular board meetings. The arguments differ with this research in the sense that this research mainly explores the role of the board of directors whereas my research will explore other solution such as criminal liabilities. The gap in the knowledge that the study will also seek to explore is to assess the role of the regulator in curbing corporate frauds and other means.

In conclusion, the literature review has highlighted various perspectives on addressing the problem of corporate fraud. The scholars have given various recommendations that the study will seek to borrow and research will fill the missing gaps.

1.5 RESEARCH QUESTIONS

1. What is the existing legal and institutional framework on corporate governance in Kenya and how is it linked to corporate fraud?
2. Has the existing legal, institutional framework on corporate fraud been effective in preventing/limiting the vice?
3. What is the legal, institutional and policy framework on corporate fraud in the United Kingdom and South Africa?

[20]Sharina Mohd Salleh and Rohana Othman, 'Board Of Director's Attributes As Deterrence To Corporate Fraud' (2016) 35 Procedia Economics and Finance. 82

1.6 HYPOTHESIS

1. The first hypothesis of this research is that weak legal, regulatory and enforcement on corporate fraud is the main reason why there are many rising cases of the vice. Even though there are laws in place they have proved to be ineffective in addressing the issue of corporate fraud.
2. Secondly, the regulator in this case the Capital Market Authority has been unable to reign on corrupt directors and company employees who have committed various acts of fraud. Kenya has been unable to fully and effectively operationalize its corporate governance laws. Lack of proper corporate governance laws has led to many firms to collapse due to corporate fraud.
3. Kenya has been unable to reform its corporate governance laws and code of ethics in line with the International Standards.

1.7 THEORETIC FRAMEWORK

There are various theoretic perspectives to discussing to exploring the issue of corporate fraud. The research will analyze two major theoretic approaches to the issue of corporate governance namely; agency theory and also the stakeholder's theory and its application on the issue of corporate fraud.

1.7.1 AGENCY THEORY

The agency theory is a theoretic discourse that revolves around the relationship between the principal and the agent. The agent is normally appointed to act in the interest of the principal, and the general expectation is that he will advance and protect the interest of the principal. In the context of the company law shareholders are regarded as the owners of the capital hence they are principals, and directors and the employees are the agents of the owners. [21]

This theory is relevant in examining the issue of corporate fraud since it raises the issue of agency problem where the directors may engage in activities that may be detrimental to the interests of the owner's hence proper check and balances should be put through applying proper policies. There is a general expectation that the board of directors will exercise due diligence and have a duty of care towards the investors and the company. This entails not engaging in illegal activities such as

[21]Thomas Clarke and Thomas Clarke, *International Corporate Governance* (Routledge 2007).

receiving gifts or bribes from the third. Thus, the research will emphasize the need for the shareholders to hold the directors accountable for their wrongs.

1.7.2 STAKEHOLDER'S THEORY

The stakeholder theory is another important theory which is capitalistic and describes the interconnections between a company and its main players such as customers, employers, suppliers, communities, employees. This theory argues that a firm has a fundamental object of ensuring that it creates value to all the stakeholders and not just the shareholders. This theory majorly emphasizes moral and good ethics in the management of the firm. [22]

Corporate fraud is an issue that affects the companies since it may lead to their collapse. The collapse of companies has both economic and social ramification hence the theory emphasizes that the directors and management should ensure that the company is managed in a sustainable manner. First, the shareholders are likely to lose their investments. Secondly, the collapse of a company due to corporate fraud may lead to loss of employment opportunities. The collapse of Pan Paper Company in Webuye rendered many workers jobless. Thirdly, the creditors will also suffer since the company may not be able to repay its debts. Fourthly, it would have an impact on society since some companies engage in corporate social responsibility programs. Thus, the study will borrow on this theoretic framework to emphasize on the need to adhere to good moral and ethical principles in the management of the firms in order to avoid a negative impact to other stakeholders. There are other philosophy that can be used to promote the stakeholder theory such as the Ubuntu Philosophy that is common in South Africa that states that advocates for humanity since a company does not only exist to fulfill the wishes of the owners but rather satisfy the needs of other stakeholders. Therefore, the boards of management have a duty to promote the African philosophy so that the management and employees understand the multi-faceted role of the company.

1.8 RESEARCH METHODOLOGY

The research methodology employed in this research is Doctrinal Research Methodology. The process entails evaluating different secondary sources through qualitative study and inferring conclusion based on the various findings. This research is aimed at analyzing the legal framework of corporate governance in Kenya. The research will analyze the Constitution of Kenya, the Companies Act, Penal Code, Code of Corporate Governance, the Capital Market Authority Act and

[22] Ibid

other primary sources. In addition, it would rely on the writings of the renowned authors on the issue of corporate fraud and how companies can leverage on good corporate governance principles to avoid corporate fraud. Further, the study will benchmark with other similar jurisdictions such as South Africa and United Kingdom to understand their legal framework and corporate governance framework that deals with the issue of corporate fraud and the lessons that can be borrowed in order to improve the Kenyan laws. .

1.9 DELIMITATIONS OF THE STUDY

Despite the fact the corporate fraud is a major issue affecting many corporations in Kenya there is little local literature that has devoted to exploring the issue; hence this study would rely mostly on foreign sources. Further, another limitation is that the study will be exploring the matter from a legal perspective, but it is apparent that other political and cultural factors may be impacting on the issue of fraud and due to time constraints it wouldn't be possible to explore all other issues.

1.10 CHAPTER BREAKDOWN

CHAPTER ONE: INTRODUCTION AND BACKGROUND

This is the introductory chapter which will begin by defining what corporate governance is and also provides the general background of the work. The paper will also define what corporate scandal is and demonstrates how it has led to the collapse of many corporate firms in Kenya. For example in Kenya Uchumi Supermarket Limited, Nakumatt Limited. This part will also provide the general objective of this study, the justification and the various research questions that the study seeks to answer. It will further analyze the existing literature on the work and also the various gaps. It will conclude by providing a chapter breakdown of the subsequent chapters.

CHAPTER TWO:

This is the chapter that will review the corporate governance in Kenya and how it is linked to addressing corporate fraud. This chapter will analyze the various laws that impact corporate governance and also discuss the corporate governance code that was implemented in 2002 and whether it has been effective in addressing the issue of corporate frauds in Kenya. It will also offer a comparative study between the Kenyan code of best practice *vis a vis* the international code and assess whether it needs to be improved.

CHAPTER THREE:

Chapter Three of the work will seek to analyze the corporate governance system in South Africa and United Kingdom. Further, this chapter will provide insights on the international corporate codes code of practice with special emphasis on the UK and South Africa. The study will analyze the corporate failures in these countries and how it to development of better laws to curb corporate frauds which were a major issue affecting good corporate governance leading to the shareholders losing money. This chapter will provide an in-depth analysis on various corporate frauds in mentioned countries and how it affected the shareholders and how this crime led those countries to better improve their laws to address the issue of fraud in most of the companies.

CHAPTER FOUR:

This chapter is will provide an analysis of Chapter Two and Three. In essence, it reviews the lessons that Kenya can learn from the UK and also South Africa in order to fill the gaps in the law. The findings of this analysis will inform the recommendations.

CHAPTER FIVE:

This will be the concluding chapter that will provide the conclusion and recommendation of the work. The conclusion of the study will be based on the review of the Kenyan legal system against the international standards. It will finally conclude by suggesting various ways in which the Kenyan laws can be reformedto address the recurrent issue of corporate frauds in the Kenyan corporations. In essence, it will provide a wide array of recommendations ways of promoting good corporate governance to curb the persistent issue of frauds in most of the Kenyans firms which has led to most of them collapsing leading to massive job losses and loss of the investor monies.

2.0 CHAPTER TWO
KENYA'S LEGAL, INSTITUTIONAL AND CORPORATE GOVERNANCE FRAMEWORK THAT IMPACT ON CORPORATE FRAUD

2.1 INTRODUCTION

Corporate governance denotes the rules and guidelines that assist in the proper management of a company or firm. These rules are primarily aimed at ensuring that the company is managed in a transparent, accountable and also sustainable manner.[23] The Kenyan firms that have complied with good corporate governance rules have recorded impressive results with good financial performance.[24]Financial misstatements and corruption have been identified as the major types of fraud in state-owned corporations.[25] The rules on corporate governance have been codified in the Kenyan laws to protect ensure sustainability of Kenyan firms. The Kenyan laws and regulations that touch on corporate governance are; the Constitution of Kenya, The Companies Act 2015, the Penal Code, The Capital Markets Act, The State Corporation Act, The Mwongozo code for State Corporations, The Code Of Corporate Governance Practices For Issuers Of Securities To The Public 2015 among other laws. Although Kenya has good framework on corporate governance, there are some legal and institutional gaps that need to be addressed to reduce incidences of corporate fraud. The corporate governance principles that have been codified under the various laws mainly relates to the issue accountability, transparency, responsibility, efficiency in the management of the firms among other principles. Other than the code of conduct that will be discussed later, these principles are encapsulated under the various laws that will be discussed at length.

This chapter seeks to evaluate the Kenyan legal and regulatory framework that impacts corporate governance. In particular, the study will analyze both the strengths and weakness of the various laws that have led to the issue of corporate fraud to persist. The aim of this chapter is to explore various ways in which the Kenyan laws can be improved so as to reduce the issue of corporate fraud

[1] Tricker Bob, *Corporate Governance Principles, Policies, and Practices* (Oxford University Press 2015)
Outa Eric, "*Corporate Governance Guidelines Compliance and Firm Financial Performance: Kenya Listed Companies"* (2016) 32 Managerial Auditing Journal 891

2.2 THE CONSTITUTION OF KENYA

The Kenyan constitution 2010 is the supreme law that provides the general framework for other laws to be developed.[26] The Kenyan constitution contains various provisions that support good corporate culture, accountability and responsibility in the management of both public and private firms. The principles that impact on corporate governance are the provisions on national values and principles of governance.[27] This provision clearly stipulates that corporations in Kenya ought to be managed in a responsible and accountable manner. Also, interpreting the issue broadly it implies that all persons (including corporations) need to ensure that they adhere to good corporate practices and not engage in fraud and corrupt dealings at the expense of the investors and other stakeholders. Therefore, the Constitution of Kenya provides the basis for enforcing good corporate governance principles since it supports the issue of integrity, accountability and responsibility.

Furthermore, the constitutional right on the access of information is another important tool for the shareholders, investors, auditors, government, creditors and other important stakeholders to monitor the performance of the firm to ensure that they adhere to good corporate governance practices to minimize issues of fraud. The firm needs to publish the annual returns, have a board charter, auditors report, the human resource charter and among other to assist in complying with the law. As such, information is an important aspect that e*n*sures the investors or the public are aware of the financial status of the company. Also, it ensures that the shareholders or the public are informed about the important decisions of the company such issues to do with restructuring, merger and acquisition etc.[28] In this regard, the Constitution of Kenya under article 35 observes that "Every citizen has the right of access to information held by another person and required for the exercise or protection of any right."[29] Therefore, the Constitution of Kenya has good provisions that lay the foundation for corporate governance laws to be based. However, is too general and is dependent on statutory framework.

[26] Lumumba Patrick and Franceschi Luis, *The Constitution of Kenya, 2010: an Introductory Commentary* (Strathmore University Press 2014) 300
[27] Constitution of Kenya, Art10(2)
[28] Ibid, Art. 37
[29] Ibid Article 35(b)

2.3 THE COMPANIES ACT, 2015

The Companies Act, 2015 is the substantive law that regulates the registration, management and general administration of companies. The act contains various laws that emphasize on good corporate governance. First, it states that the directors ought to operate in a transparent, accountable and responsible manner.[30] There are both civil and criminal penalties for breach of the directors' duties and those found culpable imprisoned, fined or sued for damages.[31] The provisions are aimed at ensuring that the directors are accountable to the shareholders for any transaction they undertake. In this vein, The Companies Act has elaborate provisions that can be used to combat fraud. Although the mechanism to stop corporate fraud has not been expressly stated in the Act, the guidelines on good corporate governance can be used to ensure the incidences of malpractice are minimized. In addition, the directors who are found guilty of financial impropriety are disqualified from holding the office of the directors for a certain period of time. According to the provisions of the Companies Act 2015, section 142, 143, 144, 146 and 147 the directors have a duty to act within power, promote the success of the firm , exercise reasonable care, avoid conflict of interest among others [32]These provisions when applied strictly are a sure shield to corporate fraud.

2.3.1 The Director Duty on Acting within Power

This is the first duty of directors that is provided under the Companies Act. This means that the director should not exceed the powers that they have been given. The directors should act in accordance with the Constitution of the Company [33] For instance, the director owes the duty to the company alone and not to the nominator or the shareholders and thus, they should not use their duties to advance their own personal interests or of those who appointed them. In the case of *Nyandarua Progressive Agencies Limited v Cyrus Wahome Nduhiu & another*[34]court elaborated further on this principle and stated that if the director "substantial purpose was not the purpose for which the power was conferred, it will not matter if he exercised the power in good faith."[35]

[30]Companies Act 2015, sec 201
[31]Ibid, sec 148
[32] Ibid 145-147
[33] The Companies Act, 2015,sec 142
[34]Civil Appeal 213 of 2013 (27September, 2017) [2017] eKLR
[35]Civil Appeal 213 of 2013(27 January 2017) (2018] eKLR.

However, despite the Companies Act having good provisions on good corporate governance, there have been many cases in Kenya where the directors have exceeded their powers in exercise of their duties. For example in the case of Uchumi Limited the directors were accused of defrauding the investors Sh895 million through a flawed rights issue.[36] This clearly shows that the directors did not exercise their power properly as expected by the company constitution which made the shareholders lose money and this has also been attributed as the major reasons why the company collapsed. The Capital Market Authority upon investigation decided to charge the directors involved, however the said decision was challenged in the case of *Republic v Capital Markets Authority Ex parte: James R.Murigu And Barth Ragalo*[37]where the former directors of the Uchumi Limited moved to the High Court in the Judicial Review section seeking an order of certiorari against the regulator decision to charge them for acting contrary to the code of conduct governing public listed company on the premises that they used the power improperly and that the Rights Issue proceeds floated in November 2014 were actually received and were not used for intended purposes. The court granted their prayers and quashed the decisions. Similarly, in the KPC fraud scandal, the managing director Joe Sang was charged with the loss of millions of litres of oil under questionable circumstances.[38] These examples exemplify various ways in which the directors have been acting contrary to the power conferred to them and seeking personal gain.

2.3.2 Duty to Promote the Success of the Company

The director must promote the interest of the company directors when making key decisions involving the company ought to take into consideration both the short and long term goals of the company. This is achieved through ensuring their action benefits the members as a whole. Director actions should have regard to the long term effect of their actions; consider the interest of their employees, the reputation of the firm and other related factors.[39] Similarly, [40] through exercising independent judgment they can question issues that they see that are not done according to the law and report any issue of fraud. The earlier discussed case of Uchumi Limited

[36]Misc. Application 607 of 2016 (2016 (16 January 2018) [2018] eKLR
[37]Ibid
[38] Njuguna Kelvin and Mwangi Melanie, "False Documents, Improper Procurement Rock Sh4.5bn Kenya Power Case" (*The Star*) <https://www.the-star.co.ke/news/2018-10-04-false-documents-improper-procurement-rock-sh45bn-kenya-power-case/> accessed May 24, 2019
[39] Companies Act, Sec 143
[40] Ibid, Sec 144

shows that the actions of directors went against this principle since fraud has been cited as the major reasons why the said company failed. [41] Also, in the *Nyandarua Progressive Agencies Limited v Cyrus Wahome Nduhiu & another* [42]the court stated it does not matter if an action is done in good faith if it's shown that it does not promote the success of the business then the directors are culpable.

2.3.3 Duty to exercise reasonable care and skill

This is one of the most important duties that the director should exercise a degree of care and skill. It thus states that a director should exercise the same skill, care and diligence that would be reasonably expected of a person with the general knowledge and skills required of a director [43] If the director exercise reasonable care they would not engage in corporate fraud and they would make sure that the examine the company's balance sheet carefully to understand the financial stability of the company. In the case of *Nyandarua Progressive Agencies Limited v Cyrus Wahome Nduhiu & another*[44] the judges of the court of appeal namely Sichale, Ole Kantai and GBM Kariuki observed that Section 142 of the 2015 Act codifies the equitable rule that a director must act in accordance with the company's constitution and must only exercise his powers for proper purpose.

2.3.4 Duty to avoid conflict of Interest

Further, conflict of interest is one of the major issues that have perpetuated the culture of fraud in Kenyan firms. The act states that directors should avoid the situation where their duties with the company conflict with their personal duties. This extends to any information, property or opportunity that may arise by dint of their position with the company. [45] The act expressly states a person who is guilty of the offence of the conflict of interest is liable for a fine not exceeding 1 million shillings.[46] In the case of *Eveready East Africa Limited v Energizer Middle East and Africa Limited & another* [47] the court stated that that the directors ought to act in a manner that avoids the conflict of interest. The court elaborated on this matter by stating that the director

[41] N(14)
[42]Civil Appeal 213 of 2013 (27September, 2017) [2017] eKLR
[43] Ibid 145
[44]N(21)
[45] Ibid 146
[46] Sec 147(5)
[47]Civil Appeal 97 of 2017 **(**16th February, 2018) [2018] eKLR

should not use their position to benefit from corporate opportunities. The court analyzed the UK case of *Cooks vs Deeks* whereby the directors were able to make personal profit through incorporating a new company which obtained a contract with the Canadian Pacific Railway and stated that such action amounted to conflict of interest.

2.3.6 Duty not to accept benefits from third parties

The directors have the duty not to accept the gift from the third parties. The act further provides the conditions and states that a director should not accept a gift if it's received by virtue of him holding the said position, is due to any act or omission, or received from a person that the company provides service. [48] The Act states that there are civil sanctions for breach of the duties of director and such sanction are usually determined by the court or the relevant regulatory bodies.[49] The case of *Nyandarua Progressive Agencies Limited v Cyrus Wahome Nduhiu & another*[50]court also elaborated on this principle and stated that the director should not use their position to benefit themselves.

2.3.7 The Auditors duty to report fraud under the Companies Act 2015

Many of the corporate frauds occur due to the fact that the directors breach their fiduciary duties and act contrary to the provisions of the law. The auditors have been given a huge role in assessing the financial status of the company. The companies Act, 2015 has donated the power to the shareholders and also the board of directors to appoint the auditors. The auditor's role is to ensure that the books of accounts of the company are accurate. The auditors who are found to have violated the law are criminally liable and can be imprisoned or fined. However, there is a serious gap in the Companies Act in the sense that the role to appoint the auditors should have been given to the audit committee of the board comprising of a person who do not have any interest on the company and normally appointed due to their neutrality. The Board of directors may misuse such powers and block the re-appointment of the auditors. And also they can by resolution remove the auditors from the company.

In the case of Uchumi Limited, one of the auditing firms known as Ernest and Young was accused of helping the Uchumi Limited to manipulate their books in collusion with the company

[48] Sec 147
[49] Sec 150(1)
[50]N(21)

former managers. [51]The forensic audit that was undertaken by KPMG revealed that between 2010-2014 Ernest and Young prepared a report on rights issue containing false and misleading information. This necessitated the regulator to send a show-cause letter to the Ernest and Young and to establish their role in the fraudulent right issue. [52]

2.3.9 STRENGTHS AND THE WEAKNESSES OF THE COMPANIES ACT

Major strengths of the Companies Act, 2015 is that it has codified the director duties which were under the common law in the repealed act.[53] In addition, the Company Act has prescribed both fines and civil remedies for members in the event that the director engages in fraud. It also allows for criminal sanctions. Under section 1002 it states that it is unlawful to form a company in order to engage in fraudulent activities or to steal from the creditors.[54]The members have been given power during the general meeting to recall the directors and also the auditors this ensures that the members have the oversight powers.

Despite the fact that the Kenyan Companies Act provides substantive provisions on the issue of proper management of public listed companies in order to seal loopholes for fraudulent dealings. The punitive measures provided to be meted against directors who do not comply with the law are still low. Also, the full implementation of the law has been a problem since the issue of corporate fraud continues to be a major issue affecting many firms to date. There is a need for concerted effort to explore the ways in which the Capital Market Authority can enforce the provisions of the law and also ensure that fraud is minimized. Further weakness noted is that the Act states that the acts of the director are valid even if it's later discovered that the appointment of the director was defective.[55] This implies that the company will be bound by fraudulent acts of the director even if they remove them from office.

Additionally, the Companies Act states that directors are personally liable for any false statements in the company's prospectus. However, it also defends the directors against liability in case the prospectus was issued without their consent or where they withdrew their consent

[51] The Nation, 'Markets regulator gets nod to probe auditors of Uchumi' (*Daily Nation*, 7 March 2017) <https://www.nation.co.ke/business/Ernst---Young-loses-bid-to-block-Uchumi-audit-probe-/996-3841200-8j3c53z/index.html> accessed 2 July 2019
[52] Ibid
[53]Companies Act, Sec 142-147
[54]Companies Act, Sec 1002.
[55]Ibid, Sec 132

before the prospectus was issued or if the statements were based on a public official document. The provision disadvantages the shareholders in case they rely on false statements provided in the company's prospectus. The shareholders can only claim any compensation for a loss if they can satisfactorily prove that the director was aware of the misstatement or consented to the issuing of the prospectus. With little or no information and access to the activities in the company, the shareholder has a small chance of proving their case. This is further made harder by the lenient punishment given to directors found culpable. [56]

Furthermore, the Companies Act in section 189 states that a person who is found guilty of fraudulent acts can act as a director at the discretion of the court. In addition, Section 318 of the Companies Act exempts directors from any liabilities for any offences discovered during liquidation of a company if it is discovered they had no intentions to defraud the company conceal its state of affairs. Proving the 'intention to defraud' is always challenging if there is no evidence linking the director directly to such acts.[57] Also, in section 402 it states that for directors to be absolved of any outcomes resulting from their ignorance or inexperience. In reference to this, using their discretionary powers, courts have ruled that there is a limit to the degree of skill and care that directors with their knowledge and experience are expected to exhibit but cannot be held liable for errors in the business.[58] This weakness needs to be addressed in order to combat fraud and ensure there are harsher penalties.

2.4 THE PENAL CODE

The Penal Code outlines various offences and penalties. The Penal code does not define what fraud is but contains provisions that criminalize fraudulent dealings at the company level. Although the Capital Market Authority has attempted to define fraud and observes that "fraud is defined as willful misrepresentation of the truth with intent to deceive by one party resulting in actual or potential loss to another party or illegitimate gain to the fraudster. This includes fraudulent sale of client shares, Insider trading, market manipulation, stealing of client funds, and manipulation of client records among other offences."[59]

[56]Ibid, Sec 188
[57]Ibid, Sec 189
[58]Ibid, Sec 402
[59]Capital Market Authority, "Capital Markets Fraud Investigations Unit"<https://www.cma.or.ke/index.php?option=com_content&view=article&id=258:capital-markets-fraud-

The Penal Code has distinguished different types of fraud. Section 317 criminalizes conspiracy to commit defrauds and anyone found culpable is liable for imprisonment for 3 years. Section 327 of the aforesaid act also imposes sanctions on fraud committed by trustees and also fraudulent disposal of trust property, section 328 prohibits fraudulent accounting by the directors or officers of corporations. Further, section 329 also prohibits officials of the company from making false statements, the act is clear that any person either as the director, auditor, the promoter who publishes or relay any information to which he knows to be false would be liable for imprisonment of 7 years. Also, the act prohibits any false accounting by the company's servant or clerk. The Penal code provides that fraud can occur if any person either as a director or company official causes false entry to be entered in the company books.[60]

Moreover, the act provides for criminal sanction for the company official who engages in the following. He/ she alter or falsify any information in the companies' documents or accounts. Secondly, makes a false entry in the book or documents of the company. Thirdly, omits or is privy to the act of omitting any such document or book. [61] The person will be held guilty and liable for imprisonment of 7 years. In the case of *Anvesh Keshavlal Shah v Republic*[62] the applicant approached the court through the Chamber Summons requesting that the court stays the sentence and grants him bail against the decision by the Nairobi Resident Magistrate court that had found him guilty of fraudulent appropriation or accounting by a director contrary to S.328 (a) of the Penal Code and also for the offence of stealing by a director contrary to S.283 of the Penal Code. Consequently, he was convicted for three years. The court declined the application stating that he had failed to prove his case and that the director that violates the law must be charged accordingly.

Furthermore, in the case of *Julius Kilonzo Maweu v Republic,*[63] the court issued orders barring the prosecution from charging the director who was accused of defrauding the company, namely Malili Ranch, Kshs. 179,134,070 which were sale proceeds of 5,000 acres of sold to the government of Kenya. The court held that he was previously charged with stealing by director in another matter and hence cannot be charged twice. In addition, the Penal Code states that any

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investigations-unit&catid=2&Itemid=219> accessed 2019
[60]Ibid, Sec,328
[61] Penal Code, 328(b)
[62]Misc. Criminal Application 675 of 2007(12th March, 2008)[2008] eKLR
[63]Criminal Appeal 189 of 2015 **(**21st July 2016)[2016] eKLR

person who either as a promoter, director, auditor, officer or the corporation either in the existing or a company that is yet to be formed creates, publishes and circulates or takes part in circulating information that is untrue with an intention to defraud a shareholder, member, creditor of the corporation is guilty of fraud. [64]Further, the act criminalizes fraudulent false accounting by servants or clerks. If the said person either falsifies, alter, destroys document belonging to the company will be guilty of offence and liable for imprisonments of 7 years.[65]

2.4.1 STRENGTHS AND WEAKNESS OF THE PENAL CODE

As the study has shown the act contains various provisions on the issue of fraud and the different forms that it manifests itself. The sentences provided are lengthy often 7 years and more. Also, it has an elaborate provision that speaks directly to the issue of fraud. Therefore, if the act is implemented to fully by now there would have been high-level convictions that would act as deterrence. However, the act has many gaps that need to be reviewed and updated to reflect the changing dynamics of corporate frauds. One problem in achieving a conviction for directors and employees who are charged with the offences of fraud is that the burden of proof is often very high. Section 107 of the Evidence Act provides for the burden of proof and it states that any person who wishes to rely on certain fact he needs to prove that indeed it exists.[66] In criminal cases, the burden of proof is on the prosecution. The Constitution of Kenya under article 49 states that every accused person has the right to be presumed innocent until the contrary is proved. This can be seen in the case of Uchumi Limited where it has been very difficult for the prosecution to get conviction, where the 14 directors who were charged with the impropriety were acquitted. [67]The Ex- Uchumi directors who were charged for the offence of irregular rights issue were set free by the courts over a flawed Sh895 million rights issue in 2014 due the fact the prosecution failed to meet the required threshold.[68]

Also, the court has been issuing orders that have interfered with the mandate of the Capital Markets Authority as seen in the case of Imperial Bank where the court stopped CMA from

[64]Ibid Sec, 329
[65]Ibid Sec, 330
[66]The Kenyan Evidence Act, Sec 117
[67]Capital fm, 'Kirubi, 13 Others Acquitted in Uchumi Case' (*Capital FM* , 24 May 2011) <https://www.capitalfm.co.ke/news/2011/05/kirubiothers-acquitted-in-uchumi-case/> accessed 27 June 2019
[68]Businessdailyafricacom, 'Ex-Uchumi directors freed in fraud case' (*Business Daily*, 22 January 2018) <https://www.businessdailyafrica.com/corporate/companies/Ex-Uchumi-directors-freed-share-issue-fraud-case/4003102-4273154-10l8t7mz/index.html> accessed 27 June 2019

investigating the matter of irregular issue of corporate bond.[69] Also In the case of National Bank Kenya the court DPP was forced to drop the charges against the National Bank director on the issue of fraud.[70] The family bank in National Youth Service scandal was cleared despite overwhelming evidence showing its involvement.[71]There is a lot of political interference with the appointment of the board of directors and the processes are mostly irregular, the process has been politicized and the removal of directors is not because of poor performance but other underhand dealings. He also notes that poor legal framework governing the issue. [72]In addition, there have been cases of political interferences in many of the cases involving directors; this has been seen in the appointment of director where the Government has resorted to award cronies and political losers.[73] Further, the length of time that takes to conclude most of these cases is very long which defeats justice causing witness fatigues there are many cases such as Uchumi, Imperial that have not been resolved. In the case of imperial bank, Uchumi Limited the courts have never concluded the cases.[74] Fraud is societal problem with a cultural connotation and the society seems to have normalized corruption.[75]

2.5 STATE CORPORATIONS ACT

State Corporations are state-owned entities that provide services and engage in diverse economic activities. They are formed mainly to accelerate growth and economic development. The

[69] Businessdailyafricacom, 'Imperial Bank directors win reprieve after court halts Sh2bn bond probe ' (*Business Daily*, 14 June 2016) <https://www.businessdailyafrica.com/corporate/Imperial-Bank-directors-win-reprieve/539550-3249718-g6cb80/index.html > accessed 27 June 2019 See alsoDaily nation , 'Imperial Bank directors win reprieve after court halts Sh2bn bond probe' (*Daily Nation* , 14 June 2014) <https://www.nation.co.ke/business/Imperial-Bank-directors-win-reprieve/996-3250416-bnkw56/index.html> accessed 27 June 2019

[70]Businessdailyafricacom, 'DPP clears ex-NBK boss in Sh1 billion fraud case' (*Business Daily*, 6 November 2018) <https://www.businessdailyafrica.com/corporate/companies/4003102-4838844-438abiz/index.html> accessed 27 June 2019

[71]Daily nation, 'Family Bank reaches deal with DPP, cleared in NYS scandal' (*Daily Nation*, 23 January 2019) <https://www.nation.co.ke/news/Family-bank-cleared-in-NYS-scandal-/1056-4947780-oylx3sz/index.html> accessed 27 June 2019

[72] Ireri Elijah, "Assessment of Problems Facing State Owned Enterprises in Kenya" (2016) 6 International Journal of Business, Humanities and Technology 40 <http://www.ijbhtnet.com/journals/Vol_6_No_4_December_2016/6.pdf>

[73] Businessdailyafricacom, 'Let people of integrity head our parastatals' (*Business Daily*, 13 December 2018) <https://www.businessdailyafrica.com/analysis/editorials/4259378-4894292-ff1whr/index.html> accessed 27 June 2019

[74] Standardmedia, 'Dubai bank directors complain delay in their case' (*Standardmedia* , 11 October 2016) <Dubai bank directors complain delay in their case> accessed 27 June 2019

[75] Standardmedia, 'How our cultural roots predisposes us to corruption ' (*Standardmedia*, 29 June 2018) <https://www.standardmedia.co.ke/article/2001285939/how-our-cultural-roots-predisposes-us-to-corruption> accessed 27 June 2019

example of State Corporations in Kenya are; Uchumi Company Limited, National Bank Company Limited, Kenya Power and Company Limited among others. The aforesaid Act regulates the operations of the state corporations.

On the issue of corporate governance, the state Corporation Act states that the board of management should be accountable and manage the affairs of the company in a proper manner for all the funds received. It further proceeds to state that the Chief Executive Officer may be summoned by the Parliament to answer to audit queries from a report of the Auditor-General concerning the State Corporation. In addition, the State Corporation Act states that any officer or the state corporation who fails to avail any book for inspection to the Auditor General shall be guilty of an offence and when convicted can be imprisoned for three years or fined 10,000 shillings. [76]

2.5.1 STRENGTHS AND THE WEAKNESSES OF THE STATE CORPORATION ACT

The strengths of the state corporation Act is that it has provided for the framework of proper management of the state corporations in Kenya. It has given the power to the Auditor to provide report and question any spending on the state corporations. Also, the parliament has been given a huge role in monitoring the performance and at any time it can summon the Chairman to answer to the various audit queries. There is political patronage in the appointment of the board of directors which ultimately leads to fraud due to the power appointment given to the President to appoint the board of the state corporations.[77]Also, there is no meritocracy in the appointment of directors in most of the state-owned corporations. [78]Further, the penalties provided under the Act are very low and should be enhanced to deter crime. For instance, non-compliance with the audit queries attracts a fine of 10,000 or 3 years in prison. The sentences and fines need to be harsher to deter any form of corruption.

2.6 CORPORATE GOVERNANCE CODE

This is the code of ethics that is aimed to ensure that the public listed company adheres to good

[76]State Corporations Act, sec 29

[77] Daily nation, 'Protest as Jubilee election losers and cronies picked to head parastatals' (*Daily Nation*, 28 December 2013) <https://www.nation.co.ke/news/politics/Protest-as-Uhuru-appoints-election-losers-to-head-parastatals/1064-2128110-dqfpi4/index.html> accessed 27 June 2019

[78] The East African, 'Sycophancy and political loyalty still express tickets to top state jobs in Kenya ' (*The EastAfrican*, 18 January 2018) <https://www.theeastafrican.co.ke/OpEd/comment/Sycophancy-political-loyalty-tickets-to-top-state-jobs-in-Kenya/434750-2150584-ugelviz/index.html> accessed 27 June 2019

corporate practices that are accepted both locally and internationally.[79]These ideas have been extensively developed by the different jurisdiction through several taskforces and committees including but not limited to the United Kingdom, Malaysia, South Africa, Organization for Economic Cooperation and Development and the Commonwealth Association for Corporate Governance. The guidelines are not compulsory and therefore non-compliance is major issue.

2.7 THE CODE OF CORPORATE GOVERNANCE PRACTICES FOR ISSUERS OF SECURITIES TO THE PUBLIC 2015

The Capital Market issued a code of corporate governance titled "Code of Corporate Governance Practices for the Issuers of Securities to the Public 2015". The code of conduct applies to the companies that issue both debt and equity securities to the public regardless of whether or not they are listed. Through this code, the CMA seeks to strengthen the corporate governance practices beyond what is provided by the companies Act, 2015. Boards are mandated to enact further internal policies and strategies that would ensure the sustainability of the business in order to protect the shareholders, stakeholders and the community at large. In its preamble it states that" The code sets out the principles and specific recommendations on structures and processes, which companies should adopt in making good corporate governance an integral part of their business dealings and culture."[80]

The code contains various recommendations on better management of companies through advocating for the transparent appointment of the board of directors, ensuring there is right composition of the board, addresses the issue of diversity, improving the stakeholder relations among other things. The most relevant provision with regard to the study under discussion is the provisions internal control, accountability and risk management. It states the board has an important duty to ensure that they enact adequate system and processes of accountability. Under section 6.1 the code states that the board should put in place structures that to ensure truthful and factual representation of the company financial status through review by the Audit Committee

[79] Capital Market Authority, "Code of Corporate Governance Practices for Issuers of Securities to the Public 2015 "(*Capital Market Authority*) <https://www.cma.or.ke/index.php?option=com_phocadownload&view=category&id=92&Itemid=285> accessed May 29, 2019

[80]Ibid

and ensuring that competent auditors are hired to review the company's financial records. [81]

Further, the Code provides that the board should be responsible for the accuracy of the financial statements. Moreover, it states that the members at the AGM should appoint the auditors pursuant to the provisions of the Companies Act, 2015. To avoid the auditors being compromised the code states that the auditors should not stay at the company for long term to ensure independence, professionalism and objectivity and it recommends that the auditors should be rotated after every 6 to 9 years. It further recommends that the board should introduce integrated reporting. [82] Integrated reporting is defined as a communication process that relays the information about the company strategy, governance and performance. The main aim of integrated reporting is to show how the company is creating value over time. Therefore, incorporate governance integrated reporting helps to communicate the company performance which helps the stakeholder to know whether it's complying.

Also, the code seeks the establishment of the audit committee with the power and function that would improve accountability and monitoring. The audit committee would oversee the issue of financial reporting, monitors the issue of compliance with the Laws and the code of conduct, oversee the appointment of the external auditor. In addition, it advocates for transparency and disclosure as the fulcrum of better management of the firms. Through timely and balanced disclosures, compliance with the laws and encourages whistle blowing among other things there would be better management of the firms. [83]

2.7.1 STRENGHTS AND THE WEAKNESSES OF THE CODE OF CORPORATE GOVERNANCEPRACTICES FOR ISSUERS OF SECURITIES TO THE PUBLIC 2015

The code has been lauded as the most comprehensive document that seeks to enhance corporate governance practices among the public listed firms. The code is modeled around the best practice internationally and has borrowed important concepts in developed jurisdiction such as the United Kingdom and America. First, the code ensures there is transparency and accountability in the manner the board runs the operations of the company, it addresses important such as the composition of the board, recommends that the maximum age of a director should be 70 years

[81] Ibid
[82] Ibid
[83] Ibid

which means only competent persons who have been in good condition should oversee the management of the company. In addition, it recommends that the age of diversity in the board composition should be embraced to address the problem of gender inequality that is prevalent in many of the companies. It also discusses the role of committees in enhancing good corporate governance among other things.

Although the code contains good guidelines, it is not binding. Also, the lack of penalties within the guidelines is a major issue since without any sanction such guidelines would be disregarded. Also, the Capital Markets Authority Guidelines appear to be focused on the shareholders rather than stakeholders' interests. Shareholder interests concern the policies and the structures that the Capital Market Authority has put in place to protect the investors who are the owners of the capital. On the other hand, there are stakeholder interests such as the customers, creditors, community, and employees among other interests groups. Thus, the code was developed more to maximize the shareholder values as opposed to protecting the rights of other parties.

2.8 MWONGOZO CODE FOR STATE CORPORATIONS

The Mwongozo is a code that regulates operations of the Kenyan state corporations which was promulgated in the year 2015. The purpose of the code to address the governance challenges witnessed in many of the state corporations in Kenya and entrenching the values of good corporate governance. It states that the Board has s huge role to ensure compliance with the law and offer general oversight duty on the management of the company. For instance, it provides for the half-yearly and annual reporting, discloses the financial position of the statutory board. Under Chapter three it advocates for accountability, internal control and risk management. More particularly, on financial reporting it states that the board should ensure that the book is prepared in a timely manner, ensure that the external auditor reviews the financial books of the state corporation, and recruit competent external auditors. Further, it states that an effective internal control system should be put in place to ensure that monitors any weakness that has been identified by the auditor. The Audit Committee and the External Auditor should be men and women with requisite knowledge, experience in financial management among other things. [84]

Thus, in a nutshell, it outlines the principles of good corporate governance to include but not

[84] State Corporation Advisory Committee , "A Code of Governance for Government Owned Entities (Mwongozo) "(*SCAC*January 2015) <http://www.scac.go.ke/2015-02-16-09-34-58/mwongozo> accessed May 29, 2019

limited to ethics and integrity, avoiding conflict of interest, and whistle blowing. [85] In addition, Mwongozo code has placed responsibility on the shareholders to monitor the conduct and the performance of the board, appointing external auditors to the company and approving the financial statements. [86]

2.8.1 STRENGHTS AND THE WEAKNESSES OF MWONGOZO CODE FOR STATE CORPORATIONS

One of the major strengths of the Mwongozo code is that it has professionalized the manner in which the state corporations are run and managed. It contains important provisions on corporate governance that are important such as instilling ethics and integrity in the management of thestate corporations. Also, it recommends that the external auditors should be appointed to check the firm's financial records. Despite the fact, Mwongozo code for state corporations has good provision that supports good corporate governance and can help to reduce fraud among the state corporations there are various weaknesses. One of the major weaknesses is that most of the state corporations act in disregard of the said guidelines many of the board members have been found guilty of engaging in fraud. For instance, the Kenya power and lighting company directors and top managements have involved in fraud cases and also corruption.[87]Uchumi Limited collapsed due to fraud that was committed by the directors in disregard of the Mwongozo Code.[88]Secondly, the code governance is not anchored in law and is merely guidelines and thus compliance is a difficult task.

2.9 THE ROLE OF THE CAPITAL MARKETS AUTHORITY IN REGULATING GOOD CORPORATE GOVERNANCE

The (CMA) is a body that was established in the year 1989 as a statutory agency under the Capital Markets Authority Act Cap 485A. [89]The body has a wide range of powers to include

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[85] Ibid
[86] Ibid
[87]The Standard, "Power Bosses Spend Fourth Night in Cells" <https://www.standardmedia.co.ke/article/2001288328/kenya-power-top-managers-face-prosecution-over-sh759-million-fraud> accessed June 28, 2019
[88] Standardmedia, 'Audit: The scam that was Uchumi Supermarketsâ€™ Sh895m rights issue' (*Standardmedia*, 21 August 2018) <https://www.standardmedia.co.ke/article/2000212853/audit-the-scam-that-was-uchumi-supermarkets-sh895m-rights-issue> accessed 28 June 2019
[89] CMA, "Establishment of the Capital Markets Authority" (*Capital Market Authority*) <https://www.cma.or.ke/index.php?option=com_content&view=article&id=10&Itemid=167> accessed May 10, 2019

oversight of market participants and issuing of new regulations. The CMA is also responsible for approving new licenses, listings, takeovers and other transactions. The agency also investigates complaints about non- compliance within the regulations, issue reprimands, fines or refers cases to the Director of Public Prosecution for prosecution.

The enabling Act was enacted primarily to ensure that public listed companies are managed in a professional manner and also the said companies comply with code of conduct. It establishes the Capital Market Authority; bodies with a mandate of ensuring that public listed company adhere to certain guidelines that are aimed at protecting the investors, the Act has a certain provision that ensures that companies are regulated in a professional, accountable and responsible manner.[90]

The Capital Markets Authority in 2002 committed itself to develop rules that meet international standards. [91] Since 2004, the CMA has been posting compliance statistics in its annual reports where companies that are publicly held have a duty to file their annual reports to the Capital Markets Authority on their compliance and non-compliance. In addition, the Capital Market Authority has established the Fraud Investigation Unit which was established in the year 2009 with the sole aim of detecting, preventing and apprehending the offenders who are found to engage in fraud. Also, they have the role of collecting relevant intelligence information on fraud activities. Also, it has the mandate of investigating and prosecuting the cases in the securities market. Also, assist the members of the public with relevant information on fraud. [92] It has also enhanced whistle blowing in the on the case of fraud.[93]

2.9.1 CHALLENGES FACED BY THE CAPITAL MARKET AUTHORITY

CMA has not been able to fully address the issue of fraud that has been occurring in the country. The regulator has in many of the occasion adopted the reactive approach instead of preventive. Despite establishing the Fraud Investigation Unit many fraud cases has continued to happen and the authority has resorted to suspending and fining the involved parties instead of preventing the

[90] Ibid
[91] Ibid
[92] Capital Market Authority , 'Capital Markets Fraud Investigations Unit' (*Capital Market Authority* , 3 May 2009) <m_content&view=article&id=258:capital-markets-fraud-investigations-unit&catid=2&Itemid=219> accessed 28 June 2019
[93] Standardmedia, 'Kenyans can now blow whistle on capital markets fraud' (*Standardmedia*, 19 July 2016) <Kenyans can now blow whistle on capital markets fraud> accessed 28 June 2019

vice. The case of Sukhumi is a classic example of how the regulator failed to stop fraud. [94]The fined meted by the body is not proportionate to the crime going by the case of Uchumi Limited, Nakumatt Limited where the director looted billions of shillings and was fined a small amount. For instance, Mr. Murigu was fined Ksh 660,000; Ragallo was fined 855,000 and were also banned from holding any public office. [95] Also, to some extent the court has been interfering with the work of the capital Authority by undermining its mandate such as quashing the decisions and also issues orders that make it unable to fully execute its mandate. [96]

2.10 THE ROLE OF THE NAIROBI SECURITIES EXCHANGE IN REGULATING GOOD CORPORATE GOVERNANCE

The NSE is an association of the stockbrokers in Kenya that was established in the year 1954. It is also the leading the Securities Exchange in East Africa. It traces its roots to the British Stock Exchange[97]. NSE through its rules and regulation is responsible for regulating its members and the conduct of public listed companies. The most important role is that of monitoring and enforcing listing obligations which ensure that listed companies constantly provide comprehensive and timely information. [98] Despite its role, the NSE has limited powers over the market intermediaries in that it could not control the structure of the board of directors or the appointment process of top administrative posts. Therefore until 2007 the Nairobi Securities Exchange could not punish or sanction the listed companies. Their powers were just limited to suggesting the best practices to the companies but had no powers to ensure that those practices

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[94] N(58)

[95] Standardmedia, 'Ex-Uchumi directors fraud case is revived' (*Standardmedia*, 6 February 2018) <https://mobile.nation.co.ke/business/CMA-revives-Uchumi-directors-fraud-case-/1950106-4294426-h9euim/index.html> accessed 28 June 2019

[96] Businessdailyafricacom, 'Court quashes CMA's ban on Kiereini's directorship Thursday, August 22, 2013 20:29' (*Business Daily*, 22 August 2013) <https://www.businessdailyafrica.com/news/Court-quashes-CMA-ban-on-Kiereini-directorship-/539546-1964324-ltiqllz/index.html> accessed 28 June 2019

See also Businessdailyafricacom, 'CMA to appeal fraud ruling on former Uchumi chief Ciano' (*Business Daily*, 3 May 2013) <https://www.businessdailyafrica.com/markets/capital/CMA-to-appeal-fraud-ruling/4259442-4543808-l9fmwg/index.html > accessed 28 June 2019

See also Businessdailyafricacom, 'Court puts off Sh185m CMA penalty slapped on Ciano' (*Business Daily*, 17 January 2017) <https://www.businessdailyafrica.com/corporate/Court-puts-off--Sh18-5m-CMA-penalty-slapped-on-Ciano/539550-3521128-henq18z/index.html> accessed 28 June 2019. See also, Ogembo Paul, 'Court stops CMA from investigating Kideroâ€™s bank accounts ' (*Standardmedia*, 2 August 2017) <https://www.standardmedia.co.ke/article/2001249992/court-stops-cma-from-investigating-kidero-s-bank-accounts?fb_comment_id=1370777663040723_1371452366306586> accessed 28 June 2019

[97] Nairobi securities exchange, 'History of NSE ' (*Nairobi Securities Exchange*, 3 May 2013) <https://www.nse.co.ke/nse/history-of-nse.html> accessed 28 June 2019

[98] Nairobi Securities Exchange - NSE Kenya" (*Nairobi Securities Exchange - NSE Kenya*) <https://www.nse.co.ke/> accessed May 10, 2019

were complied with. The companies, therefore, had window for compromise and it is this period that major fraudulent activities were recorded. The Nairobi Securities Exchange was later empowered to impose penalties to preserve the integrity of the securities exchange and protect investors from unethical market players. [99]The Nairobi Security Exchange ensures that its members comply with good corporate governance rules and those who are found to violate the rules are deregistered from trading on its platform. Further, it also works closely with the Capital Market Authority and ensures that its members comply with the set requirements.

2.11 CONCLUSION

In this chapter the study has explored the Kenyan Legal framework that impact on corporate governance. The chapter has also highlighted the strengths and the weakness of 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 corporate fraud. Much of the legal framework in Kenya particularly the current Companies Act, which is a replication of the UK Companies Act, 2015 has not addressed some of the issues. Also, stakeholder engagement and participation is important in curbing fraud. [100]

Thus, although significant progress has been made in strengthening corporate governance in Kenya, through the Companies Act 2015, provision of Code of Corporate Governance Practices for Issuers of Securities to the Public 2015, a lot more needs to be done. This should include amending the present laws including the Companies Act and Code of Conduct to reflect the international standards. In addition, the Capital Market Authority as the regulator needs to do a lot to reign on the irate directors who are defrauding the company through fraudulent transactions and address the issue of conflict of interest. Also, experts state that the reason why fraud keeps recurring in most of the companies is that the ownership of the company consists mainly of small owners and much power is delegated to the Board of directors who perform most of the functions of the company and make key decisions. Some decision may conflict both with short term or long term interest of the shareholders. Also, the second challenge emanates from the issue of monitoring. The shareholder lacks the capacity to monitor the affairs of the company.

[99] Ibid

[100]Jacob Orina and others, 'The influence of stakeholder participation on corruption levels in the public service in Kenya' [2018] 2(2) International Academic Journal of Innovation, Leadership and Entrepreneurship 17-36

CHAPTER THREE:
THE LEGAL FRAMEWORK ON CORPORATE FRAUD IN SOUTH AFRICA AND UNITED KINGDOM

3.1 INTRODUCTION

The cross-jurisdictional studies are important in designing the best law across the countries. This chapter seeks to evaluate the corporate governance framework in the United Kingdom and South Africa. The study focused on South Africa given the proximity, shared values, the same system of laws and South Africa has been developing their corporate governance laws such as the King's Report that have defined the corporate governance landscape. Also, the United Kingdom has been selected given Kenya's long history with the UK and their corporate governance code is more advanced and updated periodically to reflect the changing dynamics in society. Kenya was the colony of the British and most of the Kenyans laws have been borrowed from the UK. The study further notes that regulatory framework within the two countries may not be conclusive but nonetheless would enrich the discourse within the Kenyan laws on improving the corporate governance laws in order to address the issue of fraud.

A legal framework denotes the respective laws that impact a legal issue.[101] The regulatory framework is a term that refers to the regulatory regime such as various agencies that have been established to enforce the laws and punish those who are found to have violated the respective provisions of the law. [102]The policy framework is documents or codes that have been established by the respective bodies in order to supplement the laws.[103] Therefore, in this chapter, I aim to explore the legal, regulatory policy and institutional framework on corporate governance in South Africa and also United Kingdom. This chapter will report on the various laws in respective countries. For instance, in the United Kingdom, the study will analyze the Companies Act 2006, the Theft Act, and the Frauds Act and also other it will analyze the code of corporate governance in United Kingdom. In South Africa the study will analyze the Corporation Act, the South African Constitution and also analyze the institutional framework on corporate governance such as the Jonesburg Stock Exchange and also the policy framework such as the Kings Report. The

[101]Resourcegovernance "Legal Framework" <https://resourcegovernance.org/sites/default/files/nrgi_Legal-Framework.pdf> accessed 30 August 2019
[102]Ibid
[103] Ibid

first section will deal with the South African legal and institutional framework and also the second part will deal with the United Kingdom legal regime. The chapter will report on the legal, institutional and policy framework in the two countries which will be helpful in understanding how the Kenyan laws can be improved in order to tackle the issue of corporate frauds that have been a major issue affecting corporations in Kenya.

The study is desktop research that examines the legal regime on the issue of corporate fraud and whether there are adequate provisions and the lessons that Kenya can borrow. In this regard, it will examine the respective provisions of the law that impact on corporate fraud. Still, on this, it analyzes on the various rulings that the court has been made on the issues of corporate fraud. Furthermore, the study shall examine the institutional framework; these are the bodies that have been established to enforce the laws and whether they have discharged their duties satisfactorily. It will also explore the policy framework on the issue of corporate fraud.

3.2 THE EVOLUTION OF CORPORATE GOVERNANCE RULES IN SOUTH AFRICA

The history of the South Africa corporate governance can be traced to the passage of the 1926 Union Companies Act which led to the passage of the 1973 Companies Act which mainly borrowed from the English laws. The corporate governance laws in South Africa have undergone significant development since the end of the apartheid due to a lot of economic, social and also political factors.[104] The laws have been consistently improved in order to attract investors and achieve economic prosperity in the country. However, in the 1990s the country encountered a lot of challenges given the weak legal and statutory framework which necessitated the change laws in order to boost the investor confidence which saw the enactment of various laws such as the Insider Trading Act, and stricter listing requirements were introduced and which saw the development of the King's report. [105]

The King's report in 1994 [106]institutionalized corporate governance by proposing certain standards for the board of directors of public listed companies.[107] This came about as a result of

[104] Department of Trade and Industry South Africa, 'South African Company Law Review for the 21st Century Guidelines for Corporate Law Reform' (Department of Trade and Industry 2004) <http://www.pmg.org.za/bills/040715companydraftpolicy.pdf> accessed 2 August 2019.
[105] Ibid
[106] ID Institute of directors South Africa, 'King Report on Corporate Governance in SA' (King Report on Corporate Governance in SA, 29 November 1994) <https://www.iodsa.co.za/page/kingIII> accessed 22 August 2019
[107]Ibid.

the efforts by the Institute of Directors; the report was further amended by the King Report of 2002 [108]that contained more of voluntary code. The Third Kings report [109]was introduced in 2009 which was mainly influenced by the passage of the Companies Act, 2008. The Kings code continues to play a major role in promoting good corporate governance.

However, despite the progress in law, the issue of corporate fraud has persisted. According to PriceWaterhouseCoopers,[110] 77% of South African firms have experienced fraud. The report further observes that nature of risks vary some are internal, others external, while some regulatory and reputational. Analyzing the internal risks senior management has been highlighted as the threat and external being fraud committed by the customers. The fraud has come with its fair share of implications on the company, for instance, 19% of the South African companies have had to spend twice or even ten times on investigation in order to apprehend the perpetrators. The report notes that fraud is more likely to occur within an organization as opposed to outside. The following are the most common types of economic crimes that were noted in South Africa; Asset Misappropriation, fraud committed by the consumer, procurement fraud, bribery and corruption, business misconduct, cybercrime, human resource fraud and accounting fraud among others. [111]

In the recent past, South Africa has witnessed an unprecedented rise in the number of fraud which has affected companies that are listed on the Johannesburg Stock Exchange.[112] One of the latest and also the biggest scandal involved the Steinhoff [113]which have been noted as the biggest scandal in the South African corporate history. Steinhoff International Holdings NV shocked the South African markets when it was involved in one of the biggest accounting scandals. The directors of the company engaged in fraud and also theft. Also, South Africa's Financial Sector Conduct Authority claimed other offences were insider trading and also publishing of false and

[108]Ibid
[109]Ibid
[110] PWC, " Global Economic Crime and Fraud Survey 2018 South Africa" (*PWC*2018) <https://www.pwc.co.za/en/assets/pdf/gecs-2018.pdf> accessed July 31, 2019
[111] PWC, " Global Economic Crime and Fraud Survey 2018 South Africa" (*PWC*2018) <https://www.pwc.co.za/en/assets/pdf/gecs-2018.pdf> accessed July 31, 2019
[112]Motsoeneng Tiisetso, "PwC Investigation Finds $7.4 Billion Accounting Fraud at Steinhoff,..." (*Reuters*March 15, 2019) <https://www.reuters.com/article/us-steinhoff-intln-accounts/pwc-investigation-finds-74-billion-accounting-fraud-at-steinhoff-company-says-idUSKCN1QW2C2> accessed July 31, 2019
[113] CNBC Africa, "Inside the Steinhoff Saga, One of the Biggest Cases of Corporate Fraud in South African Business History" (CNBC AfricaJune 28, 2018) <https://www.cnbcafrica.com/insights/steinhoff/2018/06/28/steinhoff-rise-fall/> accessed July 31, 2019

misleading statements by the company.[114]The report on the alleged fraud indicated that there was a failure by the company auditors, independent directors and assets managers who failed in their respective roles. This led to the company share price to drastically fall by almost 90% on the stock exchange, the capital losses of the investors were massive.[115]The case of Steinhoff International Holdings is not just an isolated case there are many scandals that have occurred within the corporate sector involving fraud.[116] As alluded earlier one of the major impediment in the fight against fraud is that the person-in-charge has often colluded with the suspect in both concealing and defrauding the investors. The top auditing firms such as KPMG, Deloitte have been implicated in the web of corruption. [117]

Further, one of the auditing firms have been adversely mentioned in the Steinhoff Scandal is Deloitte Auditing Firm, the South African regulators have been investigating Deloitte South over their audits between 2014 and 2016, Deloitte had worked with the company for over 20 years. Deloitte is among the major auditing firms that have been embroiled in auditing scandals in South Africa. This follows also the scandals linking that have linked KPMG with Guptafamily.[118] In the case of Gumpta Family KPMG as an external auditor was accused of not identifying fraud during its auditing role. [119] Thus, there have been calls for more independence of the auditing and strict enforcement of the corporate governance rules, accounting and auditing procedures need to be reviewed to mitigate the chances of such issues arising again.

3.3 SOUTH AFRICAN LEGAL FRAMEWORK ON CORPORATE GOVERNANCE AND FRAUD

There are various laws that reinforce good corporate governance practices and also prohibit fraud. The legal framework entails both the statutory framework and also the code of conduct that has developed in the market. The laws on corporate governance include the Companies Act

[114]Ibid
[115] Ibid
[116] Bonorchis R, "South African Authorities Finally Closing In on Biggest Fraud" (*Bloomberg.com*March 6, 2019) <https://www.bloomberg.com/news/articles/2019-03-06/s-african-police-say-21-statements-taken-in-steinhoff-probe> accessed July 31, 2019
[117] Ibid
[118] Strydom Tj , 'Two more firms fire KPMG as corporate South Africa weighs links with auditor' (*Reuters*, 19 September 2017) <https://www.reuters.com/article/us-kpmg-safrica/two-more-firms-fire-kpmg-as-corporate-south-africa-weighs-links-with-auditor-idUSKCN1BU1WN> accessed 22 August 2019
[119] Doherty Raymond, "Deloitte South Africa Investigated over Steinoff Audit" (*ICAEW Economia*December 18, 2017) <https://economia.icaew.com/news/december-2017/deloitte-south-africa-investigated-over-steinoff-audit> accessed July 31, 2019

No 71 of 2008, the King's Report which is the policy guideline on the code of conduct for directors which is a tool for enforcing good corporate governance practices. Under the common law, the following elements need to be present in order to prove the case of fraud. The first element is the misrepresentation, unlawfulness, actual or potential prejudice and intention. Therefore, the study will start by exploring the South African constitutional framework on corporate governance.

3.4 THE CONSTITUTION OF SOUTH AFRICA

The constitution of South Africa was passed on 8 May 1996 and has been amended a number of times. It provides the general framework under which other laws are passed and it's the social contract between the government and the people on various issues. It has good provisions that are geared towards creating a good business environment for businesses to thrive, for instance, it promotes consumer protection, and it also promotes transparency through the provisions on disclosures and is aimed at ensuring provides a vibrant police system that is supposed to investigate and charge issues to do with fraud. [120] It also regulates the relationship between economic citizens and thus may have fundamental implications for company law.

The shareholders invest their money in a company through owning shares. The shares are in itself a property that has value and can be sold to another person. When the company or the directors engage in fraud they deprive the owners their property illegally. The said action is unlawful since it violates the constitutional and other legal provisions. The property rights are well encapsulated under the Article 25 which states that no person can be deprived of property except in terms of the general application of the law, and no law may permit arbitrary deprivation of property. [121]

The shareholders and other stakeholders such as the creditors have the right to access the information about the financial status of the company and promptly informed about any major decision. Studies have shown that the right to information can be an important tool where the shareholders can apply the appropriate check and balances on the board of directors and the management. At times the directors would act in a manner that is contrary to the rights and

[120] Department of Justice, "The Constitution of South Africa, 1996
"<http://www.justice.gov.za/legislation/constitution/SAConstitution-web-eng.pdf> accessed July 31, 2019
[121] Ibid, sec 25

interest of the shareholders and the right of information makes them take the necessary action through meeting by either voting out the directors or the auditors. It is at this backdrop that article 32 on the right to information becomes an important provision that can be used to enhance the shareholders and other stakeholder's right. Although some authors may argue that the literal interpretation implies the information held by the state, however, article 32(b) makes references to information held by another person and which may be important or needed for the protection of the right. The parliament has also been given the power to create a law that can give force into this provision. [122]

The South African constitution provides the general framework under which the other laws are based. It supports good governance practices that are important in creating a good environment for doing business and establishes a robust police force to investigate issues with fraud and charge the persons involved as per the law. However, the weakness is that the constitution only provides the general framework and depends on other laws to bring its provision to force. Also, some state agencies created by the Constitution have not been able to stop some cases of fraud from occurring. Also, laws created have not been able to stop fraud. [123]

3.5 THE SOUTH AFRICAN COMPANIES ACT

The Companies Act provides for the memorandum of association which is an important tool that states the object of the company and prohibits any director or any person from acting contrary to the said provisions. [124] The act is instructive that the memorandum of the article is a binding document between the corporation and the stakeholders, shareholders, and also between the company and the directors and audit committees of the board.[125] The right to information is also provided by the South African company law. Under Section 26 of the said act the stakeholders have the right to access of information. The act states that any person who has a beneficial interest in the securities issued by the company and has the right to inspect the record and scrutinize any information contained therein. Also, the stakeholders may pursue further rights in accordance with the provisions of the Promotion of Access to Information Act, 2000. [126]The Act

[122]Ibid Sec 32(b)
[123] Ibid
[124] South Africa, Companies Act 2008, Sec 15(1)
[125] Ibid
[126] Ibid 26

creates an offence but it does not state the punishment for such offence hence the provision is ambiguous since it's not clear which penalty must be applied. [127]

In addition, Section 28 of the Companies Act states that the company must keep an accurate financial record of the company, and it must be prepared in the prescribed format as provided by the law and such record must be accessible and kept in the registered office of the company. This section makes it an offence for the company to deceive or mislead the company, falsify the records or fail to keep the company record and a person who is found to have committed such acts should be punished by law. However, this provision does not state what would be the punishment for someone who is found to have contravened the said provision. [128]

Further, section 29 provides various conditions on what the financial statements of a company should entail and states that such information should not be misleading. In addition, under section 30 a company must prepare annual financial statements which must be audited and must include the auditor's report, report of the directors. The Act under section states that the company must file annual returns.[129]Section 69(1) the Act it states that a person who has been removed from office as a result of the breach of trust due to dishonesty, convicted or fined as a result of fraud or misrepresentation cannot be a director of any company in South Africa.[130]

The Companies Act further provides various conditions under which the director is ineligible to hold the office. First, when he/she the Memorandum of Incorporation provides grounds or when he is prohibited by the court or declared the person to be delinquent in terms of section 162. Also, he has been convicted, in the republic or elsewhere, and imprisoned without the option of a fine, or fined more than the prescribed amount, for theft, fraud, forgery, perjury or an offence involving fraud, misrepresentation or dishonesty. [131]Section 162(2) of the Act allows a shareholder, registered union that represents the shareholders or any state representative to bring a suit declaring that a director is delinquent. The ground for such an application is when the director grossly abuses his position. The South African court in the case of *Kukama v Lobelo and*

[127] Ibid 26(6)
[128] Ibid 28(3)
[129] Ibid 28
[130] Ibid, 66, 69, 71
[131] Section 69

Others[132] granted the order and ordered the director to step aside. The court stated as follows "The conduct of Lobelo in his dealings with the affairs of Peolwane 'did not measure up to the standard required and expected of a director' (para 9) and Lobelo was in breach of his fiduciary duties to Peolwane."[133]

THE DIRECTORS DUTIES

The standard of director's conducts is also provided by the Companies Act. The Act states that any person holding the position of the director should not use the position to gain an unfair advantage or cause harm to the company. The definition of the director extends to the alternate director[134] The South African court in the case of *Philips v Fieldstone Africa (Pty) Ltd [2004]*[135]has clarified that this duty extends to a person holding the office of a director in trust. The directors have both legal and ethical duty to disclose any information that is important and comes to their attention. Therefore, they must exercise their powers in good faith and also for a proper purpose.

The Duty To Act In The Best Interest Of The Company

The director must act in the best interest of the company and also discharge their duties on the degree and skill expected of a director. [136]Section 76(3*)(b)* of the Companies Act provides that directors must act in the "best interests" of the company. The Companies Act does not define what is meant by the term "best interests" of the company. However, the South African court in the case of *South African Fabrics v Millman* [137]stated that"interests" in this context are only those of the company itself as a corporate entity and those of its members.

The Duty To Act In Good Faith And Proper Purpose

The Act has provided for the director duties and it states that the director must act in good faith and proper purpose. The Act has not elaborated on what entails acting in good faith. In the case of *Fisheries Development Corporation of SA Ltd v Jorgensen & Another; Fisheries Development*

[132]*Kukama v Lobelo and Others* (GSJ) (unreported case no 38587/2011, 12-4-2012) (Tshabalala J)
[133] Ibid
[134] Section 76(2)
[135] Philips v Fieldstone Africa (Pty) Ltd [2004] 2 All SA 150
[136] 76(3)
[137]*South African Fabrics Ltd v Millman* 1972 4 SA 592 (A)

Corporation of SA Ltd v AWJ Investments (Pty) Ltd & Others [138]the South African court elaborated by stating that the degree of skill depends with the business that the company carries out. A director is not required to have any special business acumen or expertise, ability or intelligence, or even expertise in the business of the company.

The Duty Of Care, Skill And Diligence

The Act states that director must perform his duty with the care, skills and knowledge that is expected of a director carrying the duties of a director and also having the knowledge and skills expected of a director.[139]The Act further clarifies that a person would have met the said conditions if he takes the necessary steps to understand a matter or relies on the performance of legal counsels, accountants or any expert advice. These provisions were reiterated in the case of *CDH Invest NV v Petrotank South Africa (Pty) Ltd and Another***.**[140]

3.5.1 THE DIRECTOR LIABILITIES

The act also provides for liability of directors, who are found to have breached the provisions of the corporations Act, It states that a person would be held liable if it is found that he/she has contravened the fiduciary duties as established under the common law. Also, the director may be held liable "for any loss, damages or costs sustained by the company as a direct or indirect consequence of the director."[141] For instance, if he signs anything that binds the company while knowing that he does not have the authority to do or carrying the operations of the company contrary to the provisions of the Act. The director takes part in an action that is meant to defraud the directors or signed any document, financial statement or statement that is misleading and false. [142] Thus, the doctrine of the piercing of the corporate veil is an important tool to ensure that the directors do not commit fraud and hide behind the companies' name. [143] However, there are exceptions to the rule. Section 77(9) of the Companies Act provides that a court: may relieve the director, either wholly or partly, from any liability based on certain grounds. Also, it provides that a company should appoint auditors during the annual general meeting. Further, it

[138](4) *SA* 156 at p158
[139] Section 76 (3)(b)
[140]*CDH Invest NV v Petrotank South Africa (Pty) Ltd and Another (2018 (3) SA* 157 (GJ)
[141] Section 77(3) of the Companies Act
[142] Ibid
[143] Carlos Fabian Ardila Yopasa, The Precariousness of the Corporate Veil to Avoid the Phenomenon of Fraud in Companies, 15 Rev. E-Mercatoria 103 (2016).

recommends for the formation of the audit committee. [144] In the case of *Breeders' Association of South Africa v Price Waterhouse*,[145] the auditors were held liable for breach of contract and ordered to pay damages when they failed to discover fraud committed by a senior manager when they had been contracted by the company to do the auditing.

The strengths of the companies Act is that it recommends that the directors who are unfit should not hold positions should be removed. [146]It further recommends that a register of directors should be kept this is important in promoting good corporate governance culture and the unsuitable persons are not allowed to serve in the companies. [147] Also, there are a number of regulatory mechanisms that can help in preventing fraud, for instance, the provisions on the compulsory disclosures which state that the directors should declare their financial statements and also the reports. There are stiff penalties for those who are found to have breached the law. [148]Furthermore, the Minister has been given the power to appoint an inspector in order to inspect the operations of the company which is important in ensuring that the directors do not engage in fraud. Also, section 162 of the Act gives a specified person to institute a proceeding for removal of directors if they breach the law.

3.6 CRIMINAL PROCEDURE ACT 51 OF 1977

This is important legislation that provides for the procedure for a sentencing person who is found to have committed offences including corporations. For instance, the Act states that in the event that a corporation is charged for the offences the offender will be the director in the representative capacity. However, upon conviction, such a person is only liable for a fine. The Criminal Procedure provides a mechanism for the directors, companies and other company officials to be charged with the offences of fraud. For instance, a corporation can be charged for criminal liability and appropriate fine imposed. Section 332 of the Criminal Procedure Code of South Africa provides for the prosecution of the corporation and also the members associated with it for criminal acts or omission.

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[144] Ibid 165
[145]*Breeders' Association of South Africa v Price Waterhouse* (416/99) [2001] ZASCA 82.
[146] Section 220 of Act 61 of 1973 and section 71 of the Companies Act 71 of 2008
[147] Section 162 of the Companies Act 71 of 2008

It further states that in the event that a company is prosecuted for criminal liability it's the director or the servant of the company that would be charged in the representative capacity. Also, he should take the plea as instructed by the company, and convictions shall be issued depending on the criminal liability of the company. [149] However, the problem lies mainly with the enforcement of the provisions of the Act since some directors have gotten away with various offences on fraud. There have been discussions among legal scholars as to whether it is good to charge the corporations which are not a natural entity hence it's not capable of thinking for itself. The corporations do not have the physical bodies and the directors are the one who possesses the directing will of the company. Also, there are some questions that need to be addressed such as if an order for confined is made would be just that a director to be held liable for actions of the company and even jailed. [150]

Also, many directors charged with the offence of corporate fraud tend to use the justification of separate legal personality which is a legal principle that states that corporations are separate from the owners and persons who manages it. This legal justification has given some people the loopholes in law in order to continue with the vice. Also, the evidential burden seems to be so high that often times it difficult to get convictions and some scholars such as Okojie proposes that there is a need to amend the law in order to reduce the evidential burden in the corporate crime. [151] The issue of holding directors accountable was aptly captured by Jed Rakoff, a US District Judge who observed that:[152] 'If crimes are committed, they are committed by people; they are not committed by some free-floating entity. These companies and other entities don't operate on automatic pilot. There are individuals that make decisions - and some make the right decisions, and some make the wrong decisions. '

3.7 POLICY FRAMEWORK ON CORPORATE GOVERNANCE IN SOUTH AFRICA: THE KINGS REPORT

In South Africa the code that regulates corporate governance is the King's Report that was developed by the King's Committee on Corporate Governance. The report has been amended

[149] Ibid
[150]Okojie, Eric (2015) "*Corporate Fraud In Nigeria And The Dialectics* Of Management *Of Evidential Burden In Litigation*" Journal of Policy And Globalization Vol.38, (2015) 105
[151] Okojie, Eric (2015) "*Corporate Fraud In Nigeria And The Dialectics* Of Management *Of Evidential Burden In Litigation*" Journal of Policy And Globalization Vol.38, 2015.
[152] Justin Jennewine, What's Mine Is Yours: The Circuit Split over Collective Corporate Knowledge in Securities Fraud Litigation, 84 U. CIN. L. REV. 847 (2016). Pg 847

several times, the first report was developed on in 1994 and it was the King's Report 1, the first King's report was influenced more by the Cadbury report [153]and emphasized more on the functioning of the board of the director later amended in 2003 "King's Report II" which focused more on the qualitative nature of the good corporate governance and not regulatory, in 2003 "King's Report III" and lastly, revised in 2006 issuing the King's Report IV in 2006. The companies that have been listed on the Johannesburg Stock Exchange must adhere to the guidelines of the King's Report and the corporate governance code has been lauded to be the best since it has incorporated international best practice. [154]

The Kings Report V on corporate governance builds on its predecessors and provides for greater transparency in the management and operations of the public listed companies. The report in particular emphasizes on apply and explain regime and mandate the companies to be transparent in the management of its operations. The "apply and explain" principle mainly states that the organization should be more transparent in the application of their corporate governance codes. The report is instructive that good corporate governance principles operate on the notion that companies do not operate in isolation but are an integral part of the society and hence it should be accountable to the stakeholders be it the current or the future stakeholders. Thus, the report states that corporate governance is not more about compliance but rather is more of a mindful application.[155]The King's III report on corporate governance has made an immense contribution to the fight against fraud and corruption. There are four areas that have been recommended by the Kings report on leadership ethics, strategy performance and reporting, governing structures and delegation, and stakeholder relationship among others that are important in fighting graft. One of the most important provisions is that on leadership where the code states that the governing body must at all-time act ethically and effectively in the discharge of its mandate. [156]

There are various principles that the code states that must be adhered to. The first is integrity; on this, it states that the members should act in good faith and also act in the best interest of the company or the organization. Further, they should avoid conflict of interest and in circumstances

[153] Icaewcom, 'The Cadbury Report' (*Institute of Chartered Accountants in England and Wales*, 3 March 1992) <https://www.icaew.com/technical/corporate-governance/codes-and-reports/cadbury-report> accessed 27 August 2019
[154]Institute of Directors in Southern Africa "King Report on Corporate Governance in SA" <https://www.iodsa.co.za/page/kingIII> accessed July 31, 2019
[155] Ibid 6
[156] Ibid 14

where it cannot be avoided the person involved need to communicate on the onset to the governing body which will take appropriate actions in accordance with the law. Also, it states that members should strive to demonstrate higher moral standards other than just merely complying with the law which means that they should set a higher example. Also, the code places responsibility on the governing council in calculating good ethical culture on the company. [157]The second element that seeks to promote good corporate governance culture is on accountability. The code states that members should be ready to answer any questions with regard to any decision made or the manner in which they have executed their mandate. The third is on fairness; the code states that to ensure that the governing council upholds accountability the governing council should act fairly and adopt a stakeholder-inclusive approach in the execution of their mandate. The fourth element is on transparency which states that the governing council needs to be transparent in the manner they discharge their duties. These are the recommended practices for the corporation to ensure that they uphold good corporate practices. [158]

Another important topic that the code emphasizes is on organization ethics. Good organization ethics is the fulcrum that supports good ethical practices in a company and ensures that an organization is managed in a proper and transparent manner.[159]This principle proceeds from the understanding that the governing council, management and the employees of the company are the faces of the organization and therefore they need to project a good image of the organization in order to promote good image this would, in turn, boost the investor confidence and also ensure there is good relationship with other stakeholders. Thus, to ensure this provision becomes a success the governing council has been discharged with overwhelming show direction on which corporate ethics that organization need to adopt. They also need to adopt the code of ethics of the organization. In so doing, they must ensure that the internal code of conduct encompasses how the company interacts with both internal and external stakeholders and society and also address the issues to do with ethical risks. All the employees must be familiarized with the rules on corporate governance. Also, the governing council needs to provide general oversight on how the rules are formulated and implemented.[160]

[157]Ibid Sec 20
[158]Ibid 21, 22
[159] Ibid 29
[160] Ibid 30

One of the most important provisions on this section is on reporting, the governing council has the responsibility to ensure that reports that are issued by the company are able to meet the short term, medium-term and long term needs of the organization which will help the organization to make informed decisions. It thus, recommends that there should be an integrated reporting mechanism in place which must be delivered at least annually which can either be a standalone report or form part of another report. Further, the governing council must ensure there is the integrity of the external reports. Thus, the governing council must ensure that reports are published on the company's website or other platforms that can be easily accessible by stakeholders or any interested parties. There need to be timely corporate disclosures in accordance with King V Application and Application, integrated reports, annual financial statements and other external reports. [161]

Also, part 5.3 on governing structures and delegation places responsibility on the role and responsibility of the governing council to promote good corporate governance practices and ensuring accountability and better reporting mechanism. Under principle 7 the code provides for the composition of the governing council which states that it should comprise of people of the right skills, knowledge, diversity and independence and discharge its responsibility objectively. It proposes that the governing council should comprise of the independent and the non-executive members, a right number, meeting the required quorum and also aims at diversity. The CEO of the company should also be appointed to sit at the governing council of the meeting and rotation of the board. [162] Further, on the procedure of the nomination of the members to the governing council the code states that the board should approve such decisions and the process needs to be formal and transparent and ensure that the candidate possesses the rights experience, skills and knowledge. In the case that a board member needs to be re-appointed due regard needs to be given to how the incumbent performed in the office and whether he attended a meeting as required, terms of service of the governing council needs to be formalized, proper induction and development of the board. [163]

In addition, the code has strict rules that ensure that there is independence of the board and also the mechanism of avoiding conflict of interest. The code states that each member sitting at the

[161] Ibid 31
[162] Ibid 36
[163] Ibid 36

governing council should as declare the financial, economic and other interest that the person owns at least annually. Declare any conflict of interest in any transaction and a person can be declared as non-executive if it can be proved that there is no connection whether as result of position, financial or association that may likely influence his decision-making. [164]The Kings report mainly relied on the self-regulation. For instance, the Kings report I and II that were mainly based on the principle of complying and explain the principle and the King's Report on apply and explain the principle. The King's report sets good recommendations; however, they don't have the force of the Act of parliament and also sometimes self-regulation is not the ideal method of good corporate governance.

3.8 INSTITUTIONAL FRAMEWORK ON CORPORATE GOVERNANCE

3.8.1 Johannesburg Stock Exchange (JSE)

This is an important body that regulates the listing of the public listed companies. The regulations are to be found within the JSE Listings Requirements that provides for the listing requirement, reviewing, fining and suspending a firm that is found not to have complied with the rules.[165]Further, the JSE has the power to censure a company, its director or its individuals for any contravention of a certain period of time and also fine amounting to R5 million. [166]Further, penalties can be found in the Securities Act provides for more criminal sanction of any improper Act, fine not exceeding R50 million and upon conviction a term not exceeding 10 years.

3.8.2 Financial Sector Conduct Authority

This body is the financial regulator in South Africa regulating the banks, insurance companies and other firms and was established pursuant to the provisions of the Financial Sector Regulation Act 9 of 2017 (the FSR Act) and replacing the Financial Services Board (FSB) that was dissolved in 2018. [167]One of the key objectives of this body is to efficiency and also integrity in the financial markets. Also, it ensures that companies in the financial sector comply with good

[164] Ibid 37
[165] Section 3 of the Johannesburg Stock Exchange Listings Requirements
[166] Ibid, Section 3
[167] Fsca, 'Financial Sector Conduct Authority' (*FSCA*, 3 March 2018) <https://www.fsca.co.za/Pages/Vision-and-Mission.aspx> accessed 28 August 2019

corporate governance and also ensure that it promotes education and also maintains financial stability in the markets. [168]

3.8.3 Prudential Authority (PA)

This body was also formed pursuant to the Financial Sector Regulation Act 9 of 2017 (the FSR Act) this is the body has been charged with the responsibility of regulating the financial institutions and ensuring that they comply with the law. It also enforces various enforcement and disciplinary mechanism against the institution that does not comply with the law. [169] For instance, it imposed the administrative sanctions against Bidvest Bank for non-compliance with the provisions of Financial Intelligence Centre Act 38 of 2001, as amended (FIC Act). The aforesaid Act has donated the power to the authority with the role of supervising and enforcing the provisions of the Act. The Bidvest Bank was fined by this authority R5.25 million for the offence of not failure to comply with the reporting requirements as provided by the law and failure to maintain the records as provided by the law. [170]

3.8.4 South African Reserve Bank

This is the Central Bank the Republic of South Africa. It was established in the year 1921 after the passage of "Currency and Bank Act of 10 August 1920." [171]The body regulates the financial sector and also provides monetary policy. It also investigates the banks and also recommends disciplinary mechanism against those banks that are found to have contravened the provisions of the law. Some banks engage in fraudulent dealings through illicit financial flows and ensure that the financial institutions comply with the requirements of the law with regard to disclosure and the body also audits the banks and enforcing international obligation with regard to monetary policy. However, the body does not have the authority to prosecute and only recommends cases to the police for investigations. [172]

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[168]Eleonora Annunziata, Marco Frey and Francesco Rizzi, 'Towards Nearly Zero-Energy Buildings: The State-Of-Art Of National Regulations In Europe' (2013) 57 Energy.

[169] Resbankcoza, 'Prudential Authority ' (*Resbankcoza*, 3 March 2018) <https://www.resbank.co.za/PrudentialAuthority/Pages/default.aspx> accessed 28 August 2019

[170] ABC, 'Prudential Authority imposes administrative sanctions on Bidvest Bank' (*Africa Business Communities*, 29 March 2019) <https://africabusinesscommunities.com/news/south-africa-prudential-authority-imposes-administrative-sanctions-on-bidvest-bank/> accessed 28 August 2019

[171] Resbankcoza, 'South African Reserve; Regulation and Supervision ' (*Resbankcoza*, 3 March 2018) <https://www.resbank.co.za/RegulationAndSupervision/Pages/RegulationAndSupervision-Home.aspx> accessed 28 August 2019

[172] Ibid

3.8.5 South African Police Service (SAPS)

One of the bodies that have been charged with investigating duty on this matter is the South African Police Service (SAPS) that have been given the duty to investigate suspected fraud in the corporate sector and other places. The said bodies have the power to investigate, including searching seizure powers. Once sufficient evidence has been gathered they can institute proceeding either in the magistrate or the High Court depending with the nature of the crime. The enforcement authorities can only institute civil proceedings while the South African Police Service (SAPS) have the duty to institute criminal proceedings. [173] There are various orders that the court can issue with regard to the issue of fraud. The court can issue injunctions which may include the freezing orders, disclosure orders and the interim interdicts. For instance, The Asset Forfeiture Unit known as AFU, a body within the directorate of National Director of Public Prosecutions pursuant to the provisions of the Prevention of Organised Crime Act, 1998 (POCA) is authorized to seek either temporary or permanent restraining order with regard to the issue of proceed of crimes and confiscate such and return them to the state.

South Africa has a good regulatory framework that provides for the good regulatory framework that ensures companies that comply with good corporate governance practices. For instance, the Johannesburg Stock Exchange (JSE) plays an important role in listing the company and also de-lists and also fines companies that do not comply with good practices, fines them and recommends appropriate sanctions. However, the issue of enforcement has been a major issue and the issue of fraud has persisted. Also, a fragmented method of enforcement has led to delay since the process at times is long. Also, mostly it relies on the common law on the issue of fraud and therefore the matter needs to be properly defined given the seriousness. In addition, the South African companies Act has adopted a partial codification of the director duties which is not good since it may be a loophole for some directors to misuse their powers.

3.9 UK CORPORATE GOVERNANCE LAWS; ADDRESSING THE ISSUE OF FRAUD

The UK has robust corporate governance framework that is encapsulated under the Companies Code of Conduct and also other relevant laws that impact on the issue. Corporate Fraud in the UK is governed through various legislations such as the Fraud Act 2006 (Fraud Act), Theft Act 1968 (Theft Act), Companies Act, 2006 and other policy frameworks.

[173] The South African Constitution

3.10 THE FRAUD ACT

The definition of fraud is encapsulated under the provisions of the Fraud Act.[174] The said act states that a person would be held to have engaged in fraud if it is shown that he has breached the following conditions. First, it states that false representation amounts to fraud; it can either be express or implied. This happens through making dishonest false statements or intends to make the statements with the intention of making a gain for himself or cause loss to another or risk. Further, the act states that the representation is false if it either untrue or misleading and the person making such statements know that they are not true. [175]

Secondly, the issue of fraud suffices when a person's (including corporations) fails to disclose some information when they have the legal duty to do so the failure to disclose such information may be motivated by the desire to make a gain for himself or another person or rather to cause loss to another. [176]Thirdly, another form where fraud can manifest is through abuse of office. This happens when a person occupies a certain position but he fails to live up to the expectation either through the commission or omission. The act has gone further to explain what gain means this is a material benefit or otherwise. Also, there are additional offences that have been providing ds such as being in possession with materials that can be used for fraud and a person can be jailed up to 5 years. [177]

The act states that any person who is found liable to have breached either one or all the offences on summary conviction a sentence not more than one year and fine according to the law, on conviction a sentence not more than 10 years of a fine. [178] The common denominator in all the three offences is the rule about a person acting dishonestly, with the intention of making a gain for himself that causes loss to another person. Also, the act makes an offence for sole trade to participate in fraudulent activities. This section mainly applies to people that section 298 of the Companies Act, 2006 does not apply. Also, when such business is carried out mainly with the intention of defrauding the creditors, the section also applies to companies. [179]

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[174] UK Govt, "Fraud Act 2006" (*legislation.gov.uk*) <http://www.legislation.gov.uk/ukpga/2006/35/pdfs/ukpga_20060035_en.pdf> accessed July 31, 2019
[175] Ibid, Sec 2
[176] Ibid
[177] Ibid
[178] Section 1
[179] Ibid

The act also provides liability for company officers who are found to have engaged in fraud. If it can be shown that the offence was committed either with the consent of the director, manager, secretary or a person holding a similar position. In the case of *Context Drouzhba Ltd v Wiseman and Anor*[180], the court held that a person who enters into a contract as a director and signs a contract that the company will meet its financial obligation knowing to be untrue will be held liable for deceit. This act is important since it was established exclusively to handle issues to do with fraud and classifies fraud in various categories. It provides stiff penalties for persons who are found to have used their position to defraud the investors and other members of the public. The problem is that fraud remains fragmented in different laws and there is a need to codify into one law. However, the Companies Act has a narrow definition of what a director is and states the director means any person who holds the position of a director or whatever name he is called. [181]

3.11 THEFT ACT

The Theft Act is one of the substantive legislation that addresses various forms of theft and provides penalties. It's a law that was developed as a recommendation from the Criminal Law Revision Committee, 1966.[182] Section 1 of the Act defines that theft must contain five elements namely; dishonesty, an appropriation (i.e. taking), there must be property, it must belong to another person and there must be an intention to permanently deprive the owner of it. [183]

The issue of fraud is addressed in section 15 and 16 of the Theft Act, false accounting, and company offences. Section 17 of the Act addresses the issues of false accounting and describes it as an action where an individual dishonestly acts in order to cause a loss to another person through destroying, defacing, concealing, falsifying documents or records. Upon conviction, the said person will serve a sentence not more seven years. [184]Also, the company officers may be held liable for certain offences. [185] Also, the act creates an offence of false statements by the company directors and states that in the event that an officer of the company causes publishing of information that he knows to be untrue, misleading, false upon conviction he shall be liable for a

[180]*Contex Drouzhba Ltd v Wiseman* and another [2007] EWCA Civ 1201
[181] Section 250
[182] UK Government, "Theft Act 1968" (*Legislation.gov.uk*) <http://www.legislation.gov.uk/ukpga/1968/60/enacted> accessed July 31, 2019
[183] Ibid
[184] Ibid, Sec 17
[185] Ibid Sec 18

sentence of 7 years. [186] Theft Act makes an offence of fraud and there are stiff penalties for those who breach the provisions of the law. The parts that address the issue of fraud within the company are meant to enforce good governance principles and also make sure that the investors do not lose their investment. The Theft Act contains stiff penalties for those persons who are found to have engaged in fraud. It supplements other existing legislation on the matter and prohibits and forms of corporate fraud. However, there are many Acts that contains the provisions on fraud and there is a need for consolidation.

3.12 THE COMPANIES ACT, 2006

The Companies Act, 2006 has the substantive provisions in promoting good corporate governance practices and also ensuring that investor's funds are protected. The Act has placed a duty on the directors to adhere to certain standards in order to ensure that that the firms are managed in a professional manner.[187]Under section 170 of the Companies Act, the directors' duties that were initially under the common law have been codified in a move of ensuring greater transparency. The members or the shareholders of the company have been given the powers to appoint the directors and they must be voted individually. [188] Also, the members have the right to vote for the removal of a director. [189] However, the directors have the right to protest the removal if there are valid grounds.[190] In addition, the Act has codified the common law duties of the directors. The act is categorical that these duties are owed by the director to the company and some condition as regard conflict of interest and the duty of not accepting the benefit from the third parties are binding to the director even after leaving their service at the company.

The Duty to Act within Power

This is the first duty that is provided under the act. The Act provides that the director should act in accordance with the company constitution. They also need to exercise power for the purpose that they have been given this means that they should not use their powers improperly. [191] For

[186] Ibid Sec 19
[187] UK Govt, "Companies Act 2006" (*legislation.gov.uk*)accessed July 31, 2019
[188] Companies, Act 2006 Sec, 168
[189] Ibid
[190] Ibid, sec 160
[191] Ibid, Sec 171

instance, the director owes the duty to the company alone and not to the nominator or the shareholders and thus, they should not use their duties to advance their own personal interests or those who appointed them in that position.[192] In the case of *Eclairs Group Ltd v JKX Oil & Gas Plc*[193] The director of this company used their votes to stop the corporate shareholder from voting since they were apprehensive that the corporate shareholder will use the power to gain control of the company which would not be in the best interest of the company and he will drive the shares down. The court stated the directors had used their powers improperly. Although not directly related to corporate fraud, the case illuminates on the ideas that the Board of Directors should be careful not to misuse their powers.

The Duty to Promote the Success of the Business

The director needs to act in good faith and promote the success of the business as a whole. In so doing, he needs to take into consideration the following issues; the long term effects of their actions, take into consideration the interests of their workers, the need to establish a good rapport between the company and its customers and also suppliers, the need to maintain a good a high reputation of the company in terms of good business conduct and lastly the need to act fairly. [194] In the case of *Mills v Mills,*[195]the court observed that the director must act for the interest of the company and not pursue his own interest. Also, in the case of *Re Smith v Fawcett, Lord Green* [196]observed the following on the role of the directors, "exercise their discretion bona fide in what they consider – not what a court may consider – is in the interests of the company, and not for any collateral purpose." [197]

Duty to Exercise Independent Judgment

The Act also states that the director has the duty to exercise independent judgment. However, the Act states the duty would not be infringed if there is an agreement in the company constitution

[192] See the case of *Scottish Cooperative Wholesale Society Limited Versus Meyer; the case of Kuwait Asia Bank EC versus National Mutual Life Nominees[2015] UKSC 71*

[194] Ibid
[195]*Mills v Mills* [2018] UKSC 38
[196]*Re Smith and Fawcett Ltd*. [1942] Ch 304
[197] Ibid

that restricts discretion or it's in the manner that is authorized by the company constitution. [198] In the case of *Re Englefield Colliery Co*[199], a director was compelled to pay back the money when it was found that he had not exercised independent judgment. Further, in the case of *Crowther Group Plc v International Plc*,[200]the court stated that the directors are the one determine what would be in the best interest of the company. Independent judgment in this context implies that the director makes decision based on the facts and also applying his skills and knowledge without outside persuasion. [201]

Duty to Exercise Reasonable Care, Skill and Diligence

The Act states that the director has the duty to exercise reasonable care, skill and diligence. The Act has gone further to elaborate on these issues and states that the general standard would be that of a director acting for the company or the general duty that the director has. [202] In the case of *Re City Equitable Fire Insurance Co*[203] Romer elaborated well on this point by stating that this entails acting honestly and that the duty of care is that one of the ordinary people. Further, the director doesn't need to exhibit greater skills or give continuance attention to the affairs of the firm and not liable for minor errors.

The Duty to Avoid the Conflict Of Interest

Conflict of interest denotes the act of having a divided loyalty or it could be as a result of family relations, status, past working relationship and other consideration that may make a person not to discharge their duties objectively.[204]The act states that a director should not be involved in a transaction where he has either direct or indirect interests. It could be with regard to the issue of property, information or opportunity among other things. [205] The penalty for the breach of the conflict of interest is a fine a statutory maximum.[206]In the case of *Bhullar v Bhullar*[207], the court

[198] Ibid, Sec 173
[199]*Re Englefield Colliery Co* (1878) LR 8 Ch D 388 (CA)
[200]*John Crowther Group Plc. v Carpets International Plc. and Others* [1990] BCLC 460
[201]Vasudev PS Watson, Corporate Governance After The Financial Crisis (Edward Elgar 2012)
[202]Ibid
[203]*Re City Equitable Fire Insurance Co* [1925] Ch 407
[204] Hannigan Brenda, *Company Law* (Oxford Univ Press 2018)
[205]Ibid Sec 175
[206]Ibid, Sec 183
[207]*Bhullar v Bhullar* [2003] EWCA Civ 424

affirmed the duty to avoid the conflict of interest. The same decision was held in the case of *Aberdeen Railway Co v Blaikie Bros*.[208]

Duty Not To Accept Benefits from the Third Parties

The Act states that a director should not accept a gift from third parties by virtue of him holding the office of a director or doing a certain action as a result of being a director.[209] The benefits may most likely affect their judgment and also may raise other issues to do with conflict of interest and it may also lead to corruption.[210] This duty is aimed at protecting the corporation from making the director from acting from their own self-interest, thus the persons who hold the position of the directors are precluded from exploitation the said positions for the personal benefits. In the case of *Regal (Hastings) Ltd Vs Gulliver*[211]the court stated that those who make secret profits from such circumstances need to account for it. Further, in the case of *Attorney General for Hong Kong vs Reid* [212]a former Hong Kong Crown Director and former Deputy Director of Public Prosecution was involved in crimes of taking bribes in order to obstruct the prosecution of some criminals and they used the said money to buy some land. The court stated that they must account for such profits.

Duty to Declare Interest in Proposed Transaction or Arrangement

If the director has an interest in a transaction involving the company he has an obligation to reveal the nature of the interests that he/she has. Also, he must inform the other directors by giving the notice at a meeting of the director or alternatively, the notice may be in writing pursuant to the provisions of section 184 or through the general meeting. [213] However, there are some exceptions to this rule. For instance, if such a situation cannot be regarded that can give rise to the conflict of interest. Also, if the other directors are aware of and lastly it concerns a term of service that has been considered by the directors. In the case of *Cranworth in AberdeenRailway Co. v. Blaikie Brothers*[214] the court elaborated that such contract entered is voidable at the option of the company. Also, in the case of *Cowan De Groot Properties Ltd vs*

[208]*Aberdeen Railway Co v Blaikie Bros* UKHL 1_Macqueen_461
[209]Ibid, Sec 176
[210] n(76)
[211] (1976) 2 AC 134M
[212]*Hong Kong v Reid* [1993] UKPC 2 [1993] UKPC 1993
[213] Ibid, sec 177
[214](1854) 1 Macq 461

Eagle Trust Plc[215]the court stated that a director who finds himself in a position that may give rise to a conflict of interest must a matter of priority declare such interests.

3.13 STRENGHTS AND THE WEAKNESSES OF THE COMPANIES ACT 2008

The UK companies Act is the most progressive and many countries have modeled their laws based on the provisions of it. The most important legislation is on the codification of the director duties which is the best approach in addressing the issue of corporate governance and by extension stopping fraud from occurring. The Act provides stiff penalties both criminal and civil for those who breach the director duties.

The directors normally play a huge role in the success of the business due to the powers that they have to steer the direction of the company and also to make key and important decisions about it. The codifications of the director's duties have been encapsulated into the law in order to protect the company interests. The UK companies Act, 2006 have adopted a complete codification of the director duties. The codification of the director duties is one of the major strengths of the Act in addressing the issue of fraud in corporations. If there is total compliance to the director duties, the issue of fraud can be minimized since it has prohibited situation which may put directors in a position that they may get compromised or engage in activities that are detrimental to the success of the business. Also, the penalties that have been provided under the Act would be serving as deterrence to those errant directors who would want to use their positions for their own selfish interests. Also, the auditors have the role to inspect the books of accounts belonging to the company and report any anomalies. The shareholders also reserve the power to dismiss the directors during the Annual General Meeting and appoint others.

3.12 THE UK PENAL CODE

The UK Penal Code came in force on 1st June 1990 and it provides for various offences and the penalties. The Act contains provisions that prohibit any form of corporate fraud. First, it criminalizes any form of forgery under section 234 of the Act. Also, the Act criminalizes the intent to defraud under section 235. One of the major issues affecting the corporation is also false accounting. The Act under section 224 states that it's an offence for the company directors to male false statements. The Act is categorical that when a director of a company causes

[215](1991) BCLC 1045

information to be published which is false with an intention to defraud the creditors or members on the affairs of the company is guilty and will be imprisoned for 7 years.

3.13 UK INSTITUTIONAL FRAMEWORK ON CORPORATE GOVERNANCE

3.13.1 The Financial Conduct Authority

This body is the financial regulator in the United Kingdom and it operates independently from the UK government and it normally finances from the subscription fees of its members. The body is structured as a company limited by guarantee. The body was established in the year 2013. The main role of this body is to regulate the financial industry in the United Kingdom, protecting the consumers and also ensuring that the industry is stable. The firms must be approved by the Financial Conduct Authority before they undertake activities in the market and also trade in the London Stock Exchange. [216] The body has been effective in addressing some of the challenges witnessed before though it has not been able to fully contain the issue of fraud since it occurs in many forms. Also, there are some scholars who have questioned the fragmented form of enforcing corporate governance. There are many bodies that have been established leading to reduced compliance and also ineffective enforcement regime of corporate governance. [217]

3.13.2 The Prudential Regulation Authority (PRA)

This is also a financial service regulator in the United Kingdom. The body was formed pursuant to the provisions of the Financial Services Act 2012 and it works alongside the Financial Conduct Authority and it's a quasi-government regulator. The body is responsible for prudential regulation of banks, building societies, credit unions, major investment firms and insurers. It also ensures that the firm that fails does not affect the taxpayers. Thus, the statutory duties that have been provided under the Act are promoting and guaranteeing the safety of the firms it regulates in order to ensure that there is no potential harm that will be caused as a result of the failure of firms. In addition, it offers protection to the policyholders. [218] As noted earlier the issue of duplication of roles in many of the institution sometimes proves to be a challenge in enforcing good corporate governance laws and also fighting fraud.

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[216] Financial Services Act 2012, Schedule 3

[217] Louise Osemeke and Emmanuel Adegbite, 'Regulatory Multiplicity And Conflict: Towards A Combined Code On Corporate Governance In Nigeria' (2014) 133 Journal of Business Ethics. Pg 431

[218] Ibid

3.13.3 London Stock Exchange

The London Stock Exchange in the United Kingdom Sock Exchange market and is located in the city of London. [219]It was established in the year 1571 and it is among the oldest stock exchange internationally. It offers the platform for traders, business to trade in the markets and it has formulated various rules that all the firms must comply with in order for them to be listed on the Stock Exchange. The role of the London Stock Exchange enables companies from around the world to raise money from outside investors. Its main aim is to provide attractive, efficient and well-regulated markets for companies, investors and intermediaries, such as stockbrokers. There are various listing rules that the body has formulated in order to compel the firms to comply with the law and also protect the investors. For instance, a firm must have a prospector that is approved by the UK Listing Authority (UKLA) and also there are some continuing obligations of the firms such as disclosure requirements on the information that may affect the share price and also the financial results of the firms have been provided timely. [220] The major strength about the London Stock Exchange is the dispersed nature of corporate ownership which makes it possible to enforce good corporate governance since it effectively addresses the issue of control.[221]

3.14 POLICY FRAMEWORK: UK CODE OF CORPORATE GOVERNANCE

The policy framework on the UK corporate governance is provided by the UK code of corporate governance that is updated regularly to reflect the changing dynamics in the corporate sector. The main objective of the passage of the UK Code of Corporate according to the FRC is to promote transparency and accountability. [222]The code is a great tool for enhancing corporate governance and combating fraud by corporations. The approach to enforcing the code is comply or explains principle. [223] The first UK code of corporate governance was developed in the year 1992 by the Cadbury report. Over the years, the code has been revised several times to take into

[219] Investopediacom, 'What Is the London Stock Exchange? ' (*Investopedia*, 5 June 2019) <https://www.investopedia.com/terms/l/lse.asp> accessed 28 August 2019
[220] Ibid
[221] Brian R. Cheffins, Dmitri K. Koustas and David Chambers, 'Ownership Dispersion And The London Stock Exchange'S 'Two-Thirds Rule': An Empirical Test' [2013] SSRN Electronic Journal.
[222] Bahram Soltani and Christian Maupetit, 'Importance Of Core Values Of Ethics, Integrity And Accountability In The European Corporate Governance Codes' (2013) 19 Journal of Management & Governance. Pg 259
[223] Mohamed H. Elmagrhi, Collins G. Ntim and Yan Wang, 'Antecedents Of Voluntary Corporate Governance Disclosure: A Post-2007/08 Financial Crisis Evidence From The Influential UK Combined Code' (2016) 16 Corporate Governance: The international journal of business in society. Pg 507

consideration the UK corporate governance needs. [224] There have been three main versions of the code; the reforms that were undertaken in 2003 were geared towards an independent board of directors and the one in 2003 inclined more on the behaviour of the board. [225]

Under section 1 of the code, it states the board has a huge role in determining the success of the company and thus it needs to be entrepreneurial and they need to generate value for the shareholders. Also, the board to develop the companies culture and they should need by example by being people of integrity. Also, should develop appropriate risk management policies. [226] Also, the code provides for the division of the responsibilities and places responsibility on the chair by promoting a good culture of openness and ensures that the director receives prompt information. The code recommends that the board should include independent and also non-executive directors. In addition, the board should be supported by the company secretary.[227] Also, the non-executive directors should have time to meet their board responsibilities and also hold the management to account. This is in line with many studies which show that a company with many independent directors is less likely to engage in fraud. [228]

The board composition is an important tool in addressing the issue of corporate fraud. [229]The second parts of the code provide the principles governing the issue of board composition, succession and evaluation. In this regard, it states that the appointments to the board need to be made in a transparent and formal manner and a good succession plan needs to be put in place for both the senior management and also the board. The code provides further that the appointment and succession plan needs to be based on merit and should endeavor to promote diversity e.g. based on gender, ethnic and social considerations.[230]In addition, the Code provides that the board and its committee needs to have a combination of skills, knowledge and experience. It states that

[224] The Financial Reporting "The Uk Corporate Governance Code" <https://www.frc.org.uk/> accessed June 27, 2019
[225] Mohamed H. Elmagrhi, Collins G. Ntim and Yan Wang, 'Antecedents Of Voluntary Corporate Governance Disclosure: A Post-2007/08 Financial Crisis Evidence From The Influential UK Combined Code' (2016) 16 Corporate Governance: The international journal of business in society. Pg 507
[226] Ibid 4
[227] Ibid 6
[228] Gundeep Kaur Virk, 'The Influence Of Board Characteristics On Corporate Illegality' (2017) 25 Journal of Financial Regulation and Compliance.
[229] Caroline Claro Hayek, Guclu Atinc, (2018) "Corporate Fraud: Does Board Composition Matter?" (2018) 18 Journal of Accounting and Finance. See also, Hwa-Hsien Hsu and Yu-Hsuan Wu, 'Board Composition, Audit Committee Structure, 'Grey Directors' And The Incidences Of Corporate Failure In The UK' [2009] SSRN Electronic Journal.
[230] Ibid 5, 6

consideration needs to be given on the year of service and membership that is regularly renewed. On the issue of the annual evaluation of the board, consideration should be given on how the board effectively work together in order to achieve their objective, diversity and how each director contributes individually to the better performance of the firm. [231]

The code recommends that the board need to come up with the nomination committee which will be tasked with the responsibility of leading the process of appointment and ensure there is a clear succession plan between the senior management and also the board. The nomination committee should comprise of the independent and non-executive directors. Also, the chairman of the committee should not sit in the committee when it is deciding on the successor. [232]Also, the code states that the chairman that should not sit in the beyond 9 years from the date of appointment. This is to ensure that there is an effective succession plan and also there is the development of a diverse board. However, the term can be extended if there are sufficient reasons and also if the director was non-executive. [233] Further, when recruiting the chairman and the non-executive directors the process should be open advertising or external search consultancy can be used in the appointment of the directors. In the event that the company decides to choose the external search consultancy, this should be captured in the annual report accompanied with a statement of any connection that it has to either the company or the individual directors. [234]

Moreover, the code provides that there should be a rigorous and evaluation of the board of directors and the various committees. It recommends for the externally facilitated board evaluation in FTSE 350 companies this should be done at least 3 years. The external evaluator should be captured in the annual report and if has any connection with the company or any of the directors. It further states that the chair should scrutinize the reports and note the strengths and the weakness for improvement. Each director needs to read the report and if there are any rooms for development they should be willing to do so. [235] Lastly, it states that the annual report needs to describe the work of the nomination committee. The work includes the process that was used in the appointment and the succession plans used. It should also describe how the evaluation of

[231] Ibid8
[232] Ibid 9
[233] Ibid 9, 10
[234] Ibid 10
[235] Ibid 10

the board was done, describe if there is any contact between the evaluator and the board or any of the directors.[236]

On the risk audit and the internal control, the board should put in place proper internal processes that should ensure there is financial integrity. There should be both internal and also external audits. The board should also be in a position to evaluate the company financial position and financial statements. Furthermore, the board establishes the necessary procedures that will assist in managing risk and overseeing the internal control framework. Therefore, it recommends that the board should put in place an audit committee which will be tasked with the responsibility of assessing the financial statements and examine the significant financial reporting of the company. Also provide the advice on whether the financial statements that have been provided are accurate, balanced among other things. It further reviews the company internal financial records and the risk management policies among other monitoring roles. [237] The last part that the code addresses is the issue of remuneration. The company should have a clear policy on remuneration, and also the director should not determine their remuneration. Also, the director needs should exercise independent judgment when authorizing remuneration.[238]

In conclusion, The UK code of governance is the most important document that recommends how the firms need to be managed and it is updated regularly. The code contains many proposals that are important in better management of firms by recommending how the board should be composed and also having a proper succession policy in place. However, it's mostly a guiding document since it doesn't have the force of the law. Also, some scholar's states that the document is mainly premised on shareholder primacy with little accountability provisions. [239] Further, on the issue of voluntary disclosures, large firms are not complying as compared with large firms with independent directors. [240]

[236] Ibid 10
[237] Ibid 10
[238]Ibid 13
[239] Jeroen Veldman and Hugh Willmott, 'The Cultural Grammar Of Governance: The UK Code Of Corporate Governance, Reflexivity, And The Limits Of 'Soft' Regulation' (2015) 69 Human Relations.
[240] Mohamed H. Elmagrhi, Collins G. Ntim and Yan Wang, 'Antecedents Of Voluntary Corporate Governance Disclosure: A Post-2007/08 Financial Crisis Evidence From The Influential UK Combined Code' (2016) 16 Corporate Governance: The international journal of business in society.

3.15 CONCLUSION

In conclusion, the study has evaluated the South African and also the United Kingdom laws that impact on corporate governance and more particularly on fraud. Corporate fraud is an issue that both the United Kingdom Government and also the South African government have been dealing with but in South Africa the issue seems to be prevalent. There are legal, institutional and policy framework that has been developed in the said countries to combat the issue and they have been discussed at length in the study.

The study has noted that in South Africa the issue of corporate fraud is still a major issue. The Companies Act contains provisions on corporate governance that can be used as a tool to address the issue. Also, the Companies Act contains provisions that state the standard of conduct of directors and also provides for their liabilities. One the notable feature of the law is the provision that states that the director to step aside for breach of the law such as gross misconduct. Also, the courts have issued orders enforcing the provisions of the Act. Other provisions that are contained in there is the Criminal Procedure Code. Also, it has a robust institutional framework that has been used to ensure firm complies with good corporate governance. Lastly, the policy framework on corporate governance is based on the Kings Report which is based on the "comply and explain" principles that ensure firms provide various disclosures and also the directors comply with good corporate governance laws. However, the major issue seems to be enforcement of the Act

In the United Kingdom, there are also elaborate laws on corporate governance that are aimed at combating issues such as fraud. The major laws in the United Kingdom were enacted following the financial crisis in 2002. The United Kingdom has various substantive provisions that address the issue of fraud. For instance, the Companies Act 2006 has codified the director's duties which are one of the major strengths in ensuring that the directors comply with the law. The Fraud Act and also the Theft Act contains various provisions that prohibit the directors and also the employees of the company from engaging in any form of fraud. In addition, the United Kingdom code of conduct contains provisions that promote good corporate governance more particularly ensuring there are transparency and accountability in the management of firms. Also, the code has placed overwhelming role on the directors and the chairman to ensure that the law is followed. It recommends that committees such as audit, and nomination committees and also

recommends that firms should have independent and also alternative directors to ensure transparency in the management of the firms. Lastly, the institutional framework has been reformed and it has been at the forefront of enforcing laws that ensure that it minimizes issues of corporate fraud.

In conclusion, both countries that have been reviewed have on the issue of promoting good corporate governance rules that are important in preventing corporate fraud at the firm level though have been scattered in the different laws. South Africa corporate governance is more on self-regulation. The United Kingdom laws have more laws that address the different facets of corporate fraud. There are lessons that Kenya can learn from these two countries. The United Kingdom and the South African laws contain mandatory provision for filing of the annual reported and the audited financial reports. The said laws make it an offence for a director or any employee of the company to falsify any information with regard to the financial status of the company. The UK Act under section 386 states that the company has the duty to keep accurate records and makes it an offence not to adhere to the said provision. Under section 393 the company officials have the duty to file annual returns of the company. Also, the same provision is found in the South African laws under section 24-31 which states that the company must keep accurate records.

CHAPTER FOUR
ADDRESSING THE ISSUE OF CORPORATE FRAUD IN KENYA THROUGH THE LENS OF CORPORATE GOVERNANCE: LESSONS FROM THE UNITED KINGDOM AND SOUTH AFRICA

4.1 INTRODUCTION

The previous chapter began by analyzing Kenya's legal, institutional and policy framework on corporate governance. The analysis revealed that although corporate laws are in place, a legal gap exist that need to be filled in order to address some of the legal challenges that the country is facing with regard to combating fraud. In addition, the study revealed the various institutional challenges that the country is facing in enforcing the law and preventing the corporate scandals from occurring. The first challenge is enforcement where the relevant bodies tasked with the responsibility of enforcing good corporate governance practices have been unable to address the issue of corporate fraud due to lack of capacity and the failure to enforce the law as required. Moreover, the analysis shows that the courts are a major impediment in disciplining the errant directors since most of the decisions of the Capital Markets Authority have been overturned by the courts. Therefore, the analysis in this chapter will be undertaken in three major sections namely; the legal and regulatory framework; the institutional framework and the policy framework. Accordingly, the aim of this chapter is to provide analysis of the findings of the lessons learned from the United Kingdom and South Africa on the legal, institutional and policy framework on corporate governance and more particularly the various approaches that Kenya can adopt to address the problem of corporate fraud.

4.2 THE LEGAL FRAMEWORK IN THE UNITED KINGDOM AND SOUTH AFRICA: LESSONS FOR KENYA'S LEGAL FRAMEWORK

4.2.1 Directors' duties

The codification of the directors' duties in United Kingdom in the year 2006 marked a new era in the corporate governance discourse. The reforms were made primarily with the aim of ensuring there is more transparency and accountability in the management of the companies. As a result of the said changes Kenya borrowed the lessons from the United Kingdom and repealed its Companies Act 1948 and enacted the Companies Act 2015. Among the key reforms borrowed from the United Kingdom was the codification of the directors' duties. Also, South Africa has

codified the director duties in the year 2008 though it's partial codification (It does not incorporate all the duties of the directors) and hence in some parts it has to rely on common law. South Africa courts and the relevant authorities have also done a good work in enforcing the law. The Codification of the director duties also exists in Kenya by dint of reforms that were undertaken in the year 2015. However, the United Kingdom has been implementing the director duties and there are various cases that the courts have ruled which has advanced jurisprudence in this area. Four after the passage of the Kenyan companies Act, Kenya seem to be lagging behind in the implementation of the provisions of the Act. On the other hand, South Africa has also been making progress in advancing the law with regard to implementation of the director duties despite the fact that it has to rely on common law. Therefore, the lessons that Kenya can learn from the United Kingdom and South Africa is that the problem is not about the lack of laws but rather implementing the law as provided in the statutes. To this end, the Kenyan courts and relevant authorities must ensure that the provisions of the Companies Act are fully implemented to deter cases of corporate fraud. The relevance of implementing the said provisions is that there would be more convictions which will deter this form of crime.

Under the United Kingdom Companies Act, the codification of the director's duty is an important element that reinforces good corporate governance principles and every person who has been appointed to the position of the director must abide by those regulations[241]. In the past before the year 2006 the United Kingdom laws relied mainly on common law to compel directors to adhere to certain principles but after the 2009 financial crisis there was the need to codify such laws and take the necessary measures in order to protect the shareholders. [242]

As for the South African Company Act, the following rights have been codified; the duty not to use the position of the director to gain an unfair advantage or harm the shareholders, the duty not to disclose any information that comes to his attention by virtue of his position. However, if the information is less important he has no obligation to disclose. In addition, the Act states that when a person is appointed into the position of the director he must do the work in good faith and for a proper purpose; he must act in the best interest of the company. In addition, he must

[241] Nordberg Donald, "Board Ethos and Institutional Work: Developing a Corporate Governance Identity through Developing the UK Code" (2017) 3 (17) Economics and Business Review 73
[242] Gabrielsson J, W KhlifS Yamak, *Research Handbook On Boards Of Directors* (Edward Elgar Publishing Limited 2019)

perform the duty of the director with the degree and the skill that he is expected of a person holding the position of the director and having the skills and experience expected of the director[243].

The United Kingdom and the Kenyan Companies Act[244] have elaborate provisions on what constitutes a conflict of interests as opposed to South African Act. The United Kingdom on the issue of conflict of interest states that the person holding the position of the director needs to avoid situation that can either directly or indirectly put him in a situation that affects his work.[245]The same provisions are contained in the Kenyan law and are similar in object and purpose.[246]Therefore, there are striking similarities between the two laws. However, these two laws have an exception that may be undesirable in combating the issue of fraud or conflict of interest which states that "if the situation cannot reasonably be regarded as likely to give rise to a conflict of interest" or "if the matter has been authorized by the other directors."[247]The said exception opens a wide window for misuse by the directors and hence the laws need to be reformed by clearly defining what constitutes conflict of interest.

Another important duty is the duty to promote the success of the business. The United Kingdom Companies Act provides for the said law under section 172 and elaborates further that such duty encompasses the director looking at the long term consequences of their actions, the interests and the welfare of the employees, the importance of establishing good relations between the company and its stakeholders such as the customers, suppliers among others and the reputation of the company and also ensure that the company act fairly.[248]The said provision is found in the Kenyan Companies Act, 2015 under section 143 without any variations and modifications[249]. When the United Kingdom law and the Kenyan law on the duty to promote the success of the business are compared with the South African Law there are some slight differences in the sense that the terminologies used are different. The South African Act states that "the director must act in the best interest of the company"[250] but it does not contain any elaboration as to what amounts

[243]South African Companies ActNo. 71 of 2008, section 76
[244] Seethe Company Act cap 46 , Sec 175 and See the Company Act 2015, Sec 146
[245] See the Company Act cap 46, Sec 175 and See the Company Act 2015, Sec 146
[246] Ibid
[247]The Company Act 2015, Section 146(5)
[248] Ibid
[249] Kenyan Companies Act, 2015, section 143
[250]South African Companies ActNo. 71 of 2008, 76(3)b

to the best interest as seen in the Kenyan law and the United Kingdom's Companies Act. In addition, the said provision is too short and there is a need to provide more information on this duty. Thus, the United Kingdom and the Kenyan law are the same on this issue[251]. However, the differences come in the implementation of these laws. While the United Kingdom's laws are highly enforced, Kenyan courts are lenient. Therefore, Kenyan court and criminal justice system should borrow from the UK the aspect of adhering and reinforcing the law. When strict action is taken against offenders, this will act as deterrence to other directors.

Mostly, the financial scandals are often as a result of the breach of the director's duty of skill and care.[252] On the duty to exercise reasonable care, skill and diligence the United Kingdom law explains about it under section 174,[253] it states that the skills expected of the director would be one that is of a person reasonably expected to hold the position of a director and also the general skills that a director has. The same provision is found without any modification or alteration under section 145 of the Kenyan Companies Act and also the South African Companies Act under section 76.[254]

There is another important duty under the UK Companies section 176 which states that the directors must not accept gifts from the third parties by virtue of their office. The said provision is found in the Kenyan Companies Act under section 147 and the provisions are the same. [255] However, the Kenyan law contains the penalty for the breach of this provision by stating that any person who is found to have contravened the Act with the regard to the aforesaid matter upon conviction shall liable to a fine not exceeding one million shillings. The South African law does not contain this provision hence the Kenyan and the UK laws are better more particularly Kenyan which contains the penalty.

Another duty is the duty to exercise independent judgment; this is found under section 173 of the UK Companies Act.[256] The same provision is found in the Kenyan companies Act under section 144. [257] The said duty is missing in the South African laws hence the Kenyan and also the United

[251] Ibid
[252] Loughrey J, *The Director's Duty Of Care And Skill And The Financial Crisis* (Elgar 2013)
[253] UK Companies Act, Section 174
[254] See Kenyan Companies Act, Section 145
[255]South African Companies ActNo. 71 of 2008, section 76
[256] UK Companies Act, Section 173
[257] Kenyan companies Act under section 144.

Kingdom laws are better. The courts in England have further clarified on the issue in the case of *Carlyle Capital Corporation Limited (in Liquidation) and others v. Conway and others [2017]*[258]

> The broad principle behind this duty is that the company is entitled to the benefit of an actual and freely arrived at decision or judgment from those who are its directors. A director will therefore breach this duty if he merely does what he is told by others for whatever reasons, or acquiesces without question or consideration in what he is asked to do or told by others……a duty to exercise an independent judgment does not mean a duty to act entirely alone, nor to act without taking into account any views expressed or even decisions which are made by his fellow director. A director must exercise his own judgment according to his own assessment of the facts but where, for example, a director does not possess a particular expertise but is aware that one of his fellow directors does, there is nothing in this duty which obliges the first director either to make a decision without ascertaining the views of the expert director or without having regard to them, or to make himself a sufficient expert in the area that he can assess the opinions of the expert director from a position of expertise.

Furthermore, the directors have the duty to declare the conflict of interest in the proposed transactions. The UK Act under section 177 states that if a director is interested in any transaction involving the company he must "declare the nature of interest to the other directors".[259] The said information can be made in a meeting or by notice. The same provision is found within section 151 of the Kenyan companies Act and the provisions are the same. The provisions in all the laws are the same with regard to the said issue.[260]

The United Kingdom laws, the South African laws, and the Kenyan laws contain a mandatory provision for filing the annual reports and the audited financial reports. The said laws make it an offence for a director or any employee of the company to falsify any information with regard to the financial status of the company. The UK Act under section 386 states that the company has the duty to keep accurate records and makes it an offence failing to adhere to the said provision. Under section 393 they have the duty to file annual returns of the company. Also, section 441 states that the directors have the duty to returns. Also, the same provision is found in the South African laws under section 24-31 which states that the company must keep accurate records, that there should be access to the said records, annual financial statements and the annual return. The same provision is found within the Kenyan companies Act under section 683 that states that

[258] Carlyle Capital Corporation Limited (In Liquidation) and others v Conway and others, Royal Court of Guernsey, 38/2017)
[259] The UK Act Companies Act, section 177
[260] Kenyan companies Act under section 151

certain documents must be lodged with the company's director and the deadline for lodging of the financial statements within the stipulated timeline and it's an offence to fail to lodge the annual financial statement with the registrar. Under section 691 the directors must approve and sign the annual financial statements and lodge them with the registrar of Companies. In addition, the company is under a duty to lodge the annual returns to the registrar and the said annual return should contain the information about the share capital and also the shareholders and it's also an offence if a company does not lodge in time.

Other than the directors, the auditors have a huge role in assessing the financial status of the company and making the necessary reports. The UK Law under section 475 states that it's a requirement to prepare an audited report; the members have the right to require the audits. However, there are exceptions for small companies and also dormant companies. Both the public and private companies are under obligations to appoint auditors. The functions of the auditors include preparing the reports on company annual accounts, auditors report in the director's report and auditors are liable for any false entry or concealing of information. The provision is also present in the South African and Kenyan laws. Therefore, although the provisions in South Africa and the United Kingdom are also found in Kenya, Kenya is still battling fraud. Kenyan courts and other regulatory bodies should, therefore, intensify their watch over the companies to ensure that they abide by all the provisions.

4.2.2 Director's liabilities

Kenya can borrow lessons from both South Africa and the United Kingdom on director liabilities. South Africa's Company Act compels directors who are accused of gross misconduct to step aside. Also, the South Africa law contains a substantive provision on director liabilities where directors are held liable for damages, loss, and costs sustained by the company as a result of the director's failure to perform their duties. Similarly, the United Kingdom has enacted robust legislation on corporate fraud such as the Frauds Act and also the Theft Act which prohibits different forms of corporate fraud. Kenyan and the UK Company Act are similar but the United Kingdom court is been progressive in advancing jurisprudence on various issues such as director duties and liabilities as seen in the various cases that have been analyzed. Therefore, Kenyan court needs to enforce the Act more just like UK to combat corporate fraud. Additionally, Kenya can borrow and implement the provisions under the South African

Company Companies Act that compels directors involved in misconduct to step aside. The Kenyan parliament can also legislate on provisions that hold directors liable for breaching their duties. These provisions have worked in South Africa and thus, implementing them in Kenya will considerably reduce the issue of corporate fraud. Also, implementing the said provisions will ensure that the directors are careful since they understand that non-compliance with the law will attract hefty penalties.

4.2.3 Shareholder's rights

There are lessons that Kenya can learn from South Africa on shareholder rights to information. The South African laws make it a criminal offence for a company to deny its members the right to inspect the company books. Although Kenya and United Kingdom contains the same provisions on the shareholder rights to information; it does not make it an offence. Therefore, there is need to provide stiff penalties for company officials who do not provide timely and accurate information to their members. Thus, Kenya implementing such a provision will help the shareholder to detect any form of mismanagement.

The South African Companies Act contains substantive provisions that can be used to promote good governance laws and combat corporate fraud. [261] The shareholder's right to information is an important tool for enforcing good corporate governance and monitoring the company.[262] The South African company Act provides for the right to information under section 26 and states that every member has the right to inspect the company records at a fee not more than R100, 00. The Act makes an offence for the Company to deny any member the right to access the company information.[263] Also, the right to information is also contained in the UK Companies Act [264] and is defined as the "the right to receive a copy of all communications that the company sends to its members generally or to any class of its members that includes the person making the nomination."[265]Further, the members have the right to require copies of accounts and reports which include the right to require a hard copy version of document or information. The right to information is also contained in the Kenyan companies Act, the information rights under the

[261] Tanja A Börzel, *Business And Governance In South Africa* (Palgrave Macmillan 2013).
[262] Benjamin Fung, 'The Demand And Need For Transparency And Disclosure In Corporate Governance.' (2014) 2 Universal Journal of Management.
[263] South African Companies ActNo. 71 of 2008, Sec 26
[264]Companies Act 2006, Cap 46.
[265] Ibid

Kenyan companies Act is provided under section 116 and is borrowed from the United Kingdom Companies Act.[266] However, it does not provide any penalties for refusal to provide such information and the South African companies Act is elaborate since it contains the necessary sanctions. Therefore, as is happening in South Africa, Kenya should consider it an offence if a company refuses to allow the shareholders to access any of the company's information. The Act should also clearly state the amount of money the shareholders can pay if any to access the information.

4.3 THE INSTITUTIONAL FRAMEWORK IN THE UNITED KINGDOM AND SOUTH AFRICA: LESSONS FOR KENYA

Kenyan institutional framework on corporate governance is almost similar to that of the United Kingdom and South Africa. However, there are still some lessons that Kenya can learn and implement in its institutions to increase the effectiveness in addressing fraud. The regulators in South Africa and the UK have been active in taking stiff actions against individuals and corporations that engage in fraud as opposed to Kenya due to various challenges such as institutional overlap and court orders that impede on how some of the institutions work. Therefore, the Kenyan institution such as the Capital Markets Authority and the Courts needs to enforce the law without fear or favour. Also, the Kenyan courts ought to avoid making orders that subvert justice. In South Africa, the courts have ordered that directors who are accused of gross misconduct to step aside.

In the United Kingdom, the regulators in the capital markets are two main bodies namely the; Financial Sector Conduct Authority and the Prudential Authority (PA). In the UK Financial Sector Conduct Authority and the Prudential Authority (PA) were established after the financial crisis mainly with the aim of regulating the markets and also protecting the investors. [267]Other than the said bodies in the UK; the London Stock Exchange has developed stringent listing requirements mostly on disclosures in order to protect the investors such as the LSE Admission and disclosure standards and also the Plus Markets Admission Standards.[268] In South Africa, agencies such as the Johannesburg Stock Exchange have also put additional listing requirements

[266] The Companies act No. 17 of 2015
[267] Niamh Moloney, Eilis Ferran and Jennifer Payne, *The Oxford Handbook Of Financial Regulation* (Oxford University Press 2017).
[268] Sue McLaughlin, *Unlocking Company Law 2Nd Edition* (Taylor and Francis 2013).100

on disclosures to avoid the issue of corporate fraud and prevent financial crisis. Also, the Police Service has been tasked with the responsibility of investigating and charging company officials accused of corporate fraud. In Kenya, there seems to be similar regulatory framework on corporate governance. The Capital Markets Authority regulates of the capital markets and it has developed the Corporate Governance Code and other requirements that companies need to adhere to in order to address the governance challenges that firms have been experiencing[269]. Also, the Nairobi Stock Exchange has put stringent listing requirements for the firms hence enhancing good corporate governance practices[270]. Moreover, the Director of the Public Prosecution has authority to initiate criminal proceeding against the directors or company officials who engage in fraud. [271]

Thus, the two jurisdictions with Kenya have the same regulatory approach to enforcing corporate governance. The enforcement mechanism is fragmented in different bodies and there is no one body with exclusive mandate of enforcing the rules on corporate governance. One of the challenges that face Kenyan regulatory bodies is developing a good and effective regulatory framework on corporate governance[272]. The debate around the best approach to the regulatory framework has gained momentum among scholars in the financial markets and also corporate governance. The disadvantage of this approach is that there seems to be overlap of the roles and responsibilities between the different bodies. [273]For instance, companies incorporated in these countries need to comply with various bodies and also adhere to many laws. For instance, in Kenya a bank that is listed in the Stock Exchange is regulated by the Capital Markets, the Nairobi Stock Exchanges and also is further regulated by the Central Bank of Kenya. Therefore, it makes the issue of monitoring to be difficult, cumbersome and scholars are advocating for a paradigm shift in approach towards an integrated approach which is more will improve more on accountability and reduce overlap between the different bodies and create harmony since all the

[269] CMA, "Corporate Governance For Issuers" <https://www.cma.or.ke/index.php?option=com_phocadownload&view=category&id=92&Itemid=285> accessed 29 August 2019.
[270] 'Nairobi Securities Exchange (NSE) - Nairobi Securities Exchange Limited Listing Rules' (*Nse.co.ke*, 2019) <https://www.nse.co.ke/index.php?option=com_users&view=login&return=aW5kZXgucGhwP29wdGlvbj1jb21fcGhvY2Fkb3dubG9hZCZ2aWV3PWNhdGVnb3J5JmlkPTomSXRlbWlkPTA=> accessed 29 August 2019.
[271] The Constitution of Kenya 2010, Art 157
[272]Annunziata, Eleonora; Francesco Rizzi and Marco Frey, (2014), "Enhancing Energy Efficiency in Public Buildings: The Role of Local Energy Audit Programmes" (2014) 69 Energy Policy 364
[273] Ibid

tasks will be vested in a single regulator. It's also cheaper since it's costly to establish and maintain all the different bodies.

The lesson that can be learnt from the UK and South Africa concerns the enforcement of laws. Although the three country shares the same laws, UK and South Africa have made progress in preventing and addressing the issue of fraud. This is because their institutions are more active and they take stiff measures on corporations and individuals who break the stipulated laws. Thus, Kenya should learn from the two countries and enforce the existing rules to prevent and deter fraud.

4.4 THE POLICY FRAMEWORK IN THE UNITED KINGDOM AND SOUTH AFRICA: LESSONS FOR KENYA'S POLICY FRAMEWORK

There are lessons that Kenya can learn from the United Kingdom and also South Africa. The South African corporate governance code is driven by Ubuntu philosophy; Ubuntu philosophy advocates for service towards humanity and frowns upon acts that would cause harm to others such as corruption and fraud. [274]Given that South Africa is also an African country and shared values there is a need to promote a new Kenyan corporate culture that supports transparency and unity. Also, to address the issue of fraud; Kenya needs also to copy from United Kingdom and revert to "comply or explain." In this approach the boards are usually asked to state in their reports and accounts how far they complied with the Code and to identify and give reasons for areas of non-compliance. The flexible approach provided by the 'comply or explain' approach is a great strength and has been adopted in many countries and as such Kenya should borrow to ensure greater compliance.

The United Kingdom "comply or explain" principle allows the company to apply the corporate code of governance depending on their own circumstances.[275] This approach has been widely used globally and is most predominant in Europe to make the board more accountable.[276] In this type of application of the code of corporate governance often there are no formal sanctions and a

[274] Magang Tebogo and Magang Veronica, "Ubuntu or Botho African Culture and Corporate Governance; A Case for Diversity in Corporate Boards!" (2017) 6 SSRN Electronic Journal 64

[275] Andrew Keay, 'Comply Or Explain In Corporate Governance Codes: In Need Of Greater Regulatory Oversight?' (2014) 34 Legal Studies. 279

[276] Caspar Rose, 'Firm Performance And Comply Or Explain Disclosure In Corporate Governance' (2016) 34 European Management Journal. See also, Lawal Bello, 'Re: Duplication Of Corporate Governance Codes And The Dilemma Of Firms With Dual Regulatory Jurisdictions' (2016) 16 Corporate Governance: The international journal of business in society. 202

challenge of this approach often depends on the company, in other words, its voluntary compliance.[277] Some of the provision of the code that is helpful in advocating for good corporate governance that may be helpful in addressing the issue of fraud and ensuring that the company is managed well is the recommendations that the chairman of the company should have stakeholder meeting. It also recommends that the board should consist of more independent directors. Moreover, the UK provision advises that the role of the chairperson and that of the CEO should be separated. It also recommends that the board evaluation should be annual and that the board should have different committees. [278]

The South African approach to the application of the corporate governance is "apply and explain" and it's contained in the South Africa Kings IV Code.[279] This approach takes cognizance of the fact that it's not sometimes about complying but looking at how the principles can be applied. It also applies to the notion that non-compliance to the corporate governance rules may be justified under some grounds. In a nutshell the South African code advocates for a balanced board that comprises of both the executive and also the non-executive directors and also that the majority of the directors should be independent.[280]

In Kenya, the first Kenyan code on corporate governance was developed in 2002 and later amended in 2015. The code moved away from the earlier position which was "comply or explain" to now "apply and explain". It states that the rule is more principle-based rather than rule-based and it gives room for an explanation on non-compliance on some of the rules on corporate governance.[281]It states that the board needs to provide an explanation on non-compliance and it should provide a commitment that they intend to fully adopt the code. The code advocates for transparency in the appointment of the board members. The procedure should be transparent and the board should comprise of the right number. It also recommends that the board should consist of both the non-executive and also independent directors and the majority

[277] Ibid
[278] The Financial Reporting "The UK Corporate Governance Code" <https://www.frc.org.uk/> accessed June 27, 2019
[279]Institute of Directors in Southern Africa "King Report on Corporate Governance in SA" <https://www.iodsa.co.za/page/kingIII> accessed July 31, 2019
[280] Hamutyinei Harvey Pamburai and others, 'An Analysis Of Corporate Governance And Company Performance: A South African Perspective' (2015) 29 South African Journal of Accounting Research. 115
[281]CMA, "Corporate Governance For Issuers'" <https://www.cma.or.ke/index.php?option=com_phocadownload&view=category&id=92&Itemid=285> accessed 29 August 2019.

should be non-executive. The code advocates for the formation of various committees such as the nomination and audit and separation of the roles of the chair and the CEO. Furthermore, it recommends for the annual evaluation of the board including the CEO and the company secretary. The code has advocated more on the stakeholder's right to receive information about the company; good financial reporting and the board should prepare the annual financial statement and shall be responsible for its accuracy. It also recommends for the rotation of the auditors to improve their independence, objectivity and professional critique. To improve transparency there should be integrated reporting and good internal control systems. In addition, the Audit Committee has been given a huge role in providing the necessary check and balances on the financial reporting and also monitoring the financial status of the company and lastly, it advocates for more disclosures.[282]

Thus, Kenya combines the South African 'apply and explain' model with the United Kingdom laws. The code of governance in the two jurisdictions are more geared towards promoting accountability and transparency in the management of the Kenyan firm though the approach on its implementation seems to be different while the latte advocates for "apply and explain" the former is inclined towards the "comply or explain". On the key tenets of corporate governance the policy framework appears to be the same for instance, it advocates for the separation of the roles of the chair and the CEO, more emphasis is placed on the stakeholder engagement, the board should comprise of the majority of members who should be non-independent, annual board reviews, the formation of different committees among others[283]. The South African code of governance also is more inclined towards greater transparency and the board have been given a huge role through the approach to applying the code of corporate governance is similar with the South African code of governance which is apply and explain. In summation, the Kenyan code of corporate governance is more enhanced on and it's modeled around internationally best practices.

[282] Ibid See The Financial Reporting "The Uk Corporate Governance Code" <https://www.frc.org.uk/> accessed June 27, 2019 and CMA, "Corporate Governance For Issuers"' <https://www.cma.or.ke/index.php?option=com_phocadownload&view=category&id=92&Itemid=285> accessed 29 August 2019.

[283] Ibid See The Financial Reporting "The Uk Corporate Governance Code" <https://www.frc.org.uk/> accessed June 27, 2019 and CMA, "Corporate Governance For Issuers"' <https://www.cma.or.ke/index.php?option=com_phocadownload&view=category&id=92&Itemid=285> accessed 29 August 2019.

Therefore, the Kenyan policy framework on corporate governance is progressive and it's in tandem with the international best practices, it has been modeled around the United Kingdom code of corporate governance and the only difference is in the manner in which it's implemented. Also, the Kenya code of corporate governance is almost similar to the South African. The lessons that Kenya can learn is to ensure that the codes are implemented as provided by the law as seen in South Africa and the United Kingdom.

4.5 OTHER STATUTORY FRAMEWORKS THAT IMPACT ON CORPORATE GOVERNANCE AND FRAUD: LESSONS FOR KENYA

Kenya can learn from the United Kingdom statutory framework by enacting relevant laws that can help in the fight against corporate fraud. For example, it can enact Frauds Act and the Theft Act. There are no major differences between Kenyan and South African laws on the issue of corporate fraud. Therefore, the legislative reform will be important in filling the missing gaps in the law.

The Kenyan Penal Code and the United Kingdom Code contain a similar provision on corporate fraud and the penalties are the same. However, the United Kingdom has more comprehensive laws that relate to fraud. For instance, fraud is captured under the Frauds Act and the Theft Act. Moreover, the UK has a policy framework that prohibits fraud by promoting good corporate governance. In South Africa, the laws that impact on fraud includes the Constitution of South Africa that provides the general framework and establishes the police force with the power to investigate and prosecute issues to do with fraud. The other laws are the Criminal Procedure Code that provides for the criminal liability of fraud. In the Kenyan legal domain, the laws on fraud are contained in the Penal Code of Kenya and there are other statutory regimes that can be used in order to compel good corporate governance to minimize fraud such as the Capital Markets Authority Act among other laws. Kenya can adopt the Theft Act and the Fraud Act as in the UK, to address various types of fraud more comprehensively.

The United Kingdom in the year 2006 developed the Frauds Act 2006 which is stand-alone legislation that addresses the different form of Frauds. The Act has been instrumental in defining various forms of fraud such as the fraud by false representation, fraud by failing to disclose information, and fraud by abuse of position. It recommends that upon conviction a person should be sentenced to 10 years for the breach of the said provisions. Also, the United Kingdom has in

place the Theft Act 1968 which also contains the provisions on various corporate offences. The UK also adopted anti-fraud culture strategies to combat fraud in the country.[284] This acts and measures have been successful in addressing fraud in the UK, and therefore they should be adopted in Kenya to fight corporate fraud. Also, the Companies Act 2015 needs to be reformed in order to compel the directors accused of gross misconduct and breach of their duties to step aside as seen in the South African Companies. Ryder[285] also recommends adopting the differed prosecution agreements (DPA's) like the one used in the United States to increase the aggressiveness of tackling finance crimes.

4.6 OTHER REFORMS TO ASSIST IN ADDRESSING CORPORATE FRAUD INKENYA.

4.6.1 Arresting and Charging Directors and Company Officials found to be Engaging in Fraud

Corporate fraud is one of the major crimes affecting corporation leading to their collapse in Kenya. Despite the glaring statistics and the prevalence of the issue[286], few arrests have been made by the police and the directors charged. The trend of not arresting the white-collar crime is not only experienced in Kenya but also in China and the US as noted by Paoyang[287]. Hence, there is a need for the police and also the Director of Public Prosecution to arrest the directors and the company officials who engage in fraud in order to save the investors' money. Successful arrests and conviction would act as deterrence.[288] Kenya has good laws on corporate fraud and they are almost similar to the United Kingdom laws and the penalties provided are almost similar. However, the laws are there to be implemented and enforced and this is where Kenya is failing. When arresting or investigating fraud cases, the relevant bodies such as fraud commissions should act with the utmost professionalism by not allowing the directors involved

[284] Mark Button and Graham Brooks, "Mind The Gap", Progress Towards Developing Anti-Fraud Culture Strategies In UK Central Government Bodies," *Journal of Financial Crime* 16, no. 3 (2009) 229
[285] Nicholas Ryder, "Too Scared to Prosecute and Too Scared to Jail?' A Critical and Comparative Analysis of Enforcement of Financial Crime Legislation Against Corporations in the USA and the UK," *The Journal of Criminal Law* 82, no. 3 (2018) 245
[286] Pricewaterhousecoopers, 'Global Economic Crime Survey' (*PwC*, 22 September 2018) <https://www.pwc.com/ke/en/publications/economic-crime-survey.html> accessed 22 September 2019
[287] Shen Paoyang, "Local ideologies and punishment for white collar crime: Comparison between China and U.S," (PhD diss., University of California Irvine , 2017), ProQuest.
[288] Daphne W. Yiu, Yuehua Xu, and William P. Wan, "The Deterrence Effects of Vicarious Punishments on Corporate Financial Fraud," *Organization Science* 25, no. 5 (2014) 1549

in crime to manipulate them. Study shows that director's connection to the fraud commission affects the detection of fraud.[289] Well-connected directors reduce the likelihood of detecting, investigation and arresting the parties involved in fraud. Although the Kenyan laws on corporate governance are similarly good, efforts should be made to apply laws and shun corruption. Therefore, one of the greatest challenges is not the lack of laws but rather the failure by the relevant institution such as Capital Markets Authority to apply the laws.

4.6.2Strengthening the Enforcement Mechanism

There is also a need to strengthen the existing regulatory framework on corporate governance in order to fully equip the agencies with more resources in monitoring and evaluations of the companies. A study conducted by Soltani[290] identifies nine causes of corporate fraud: ethical dilemma, inefficient corporate governance, ineffective boards, inefficient control mechanisms, accounting irregularities, dominant CEOs, failure of auditors, lack of sound ethical tone and dysfunctional management behaviours. The existing legal framework should, therefore, intensify their watch along these dimensions to detect and prevent corporate fraud. The Capital Markets Authority needs to be fully equipped with more staff and also resources in order to take a more preventive approach rather than a corrective approach. Preventive approaches are aimed at preventing fraud. Such approaches include monitoring the decisions of the board members[291] and good corporate governance. Corrective approaches are applied once fraud cases have been identified and they may include arrests and fines. The existing bodies should, therefore, utilize both approaches to ensure that companies do not engage in fraud and punish those who commit fraud crimes. Also, as suggested in the study there is a need to have an integrated enforcement approach on the issue of financial regulation and place all the powers in one entity to avoid duplication and delay. An integrated method of enforcement is faster and efficient and will help in proper monitoring and preventing the occurrence of such issues. An integrated approach is the one that combines both corrective and preventive measures in financial regulation. This method will not only detect fraud but also prevent them from happening in Kenya. The best fraud detection mechanisms are the one that combines both data and the effectiveness of corporate

[289] Yu F. Kuang and Gladys Lee, "Corporate fraud and external social connectedness of independent directors," *Journal of Corporate Finance* 45 (2017) 401
[290] Bahram Soltani, "The Anatomy of Corporate Fraud: A Comparative Analysis of High Profile American and European Corporate Scandals," *Journal of Business Ethics* 120, no. 2 (2013) 251
[291] Yuehua Xu, Lin Zhang, and Honghui Chen, "Board age and corporate financial fraud: An interactionist view," *Long Range Planning* 51, no. 6 (2018) 815

governance to prevent and detect fraud.[292] Other mechanisms include fraud prevention policies, adopting international financial reporting standards, and intellectualization of the audit committee.[293] Thus, strengthening these mechanisms will be useful in detecting and preventing frauds due to close monitoring and evaluation.

4.6.3 Expediting Court Proceedings Involving Directors and Company Officials on Corporate Fraud

The courts have been cited as one of the greatest impediments in the fight against corruption and by extension corporate fraud.[294] For instance, in many of the occasion the Capital Markets Authority has charged and also barred some individuals from holding the office of directors for engaging in fraud but the courts have suspended the decisions of the Capital Markets Authority. [295]Although it is laudable that the Anti-Corruption and Economic Crime Division was established, it should be noted that several cases are yet to be concluded and this has resulted in a lack of confidence in the judiciary in dealing with corruption cases. The establishment of the Anti-Corruption and Economic Crime Division was aimed at ensuring effective case management and expeditious disposal of cases involving corruption and economic crimes. However, this is yet to be realized as Kenyans await the conclusion of several cases, for instance; the NYS scandal. Therefore, the study proposes that corruption cases should be handled in a similar manner as the presidential election petitions. [296]The cases should be challenged in the Supreme Court just as the presidential election petition to ensure that the ruling brings the best outcome. This would be possible if the parliament passes such a bill and it would ensure that justice is obtained in a timely manner and finance crimes are deterred.

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[292] Burcu Birol, "Corporate governance and fraud detection: A study from Borsa Istanbul," *Eurasian Journal of Business and Management* 7, no. 1 (2019) 44

[293] P. K. Gupta and Sanjeev Gupta, "Corporate frauds in India – perceptions and emerging issues," *Journal of Financial Crime* 22, no. 1 (2015): 79

[294] Simisola I. Akitoye, "Corporate governance regulation and control of fraud in nigerian banks," (PhD diss., University of Sheffield (United Kingdom 2015)

[295] See Misc. Application 607 of 2016 (2016 (16 January 2018) [2018] eKLR, See also, Businessdailyafricacom, 'Court quashes CMA's ban on Kiereini's directorship Thursday, August 22, 2013 20:29' (*Business Daily*, 22 August 2013) <https://www.businessdailyafrica.com/news/Court-quashes-CMA-ban-on-Kiereini-directorship-/539546-1964324-ltiqllz/index.html> accessed 28 June 2019;

[296]See The Constitution of Kenya, Article 140. It states as follows: 140. (1) A person may file a petition in the Supreme Court to challenge the election of the President-elect within seven days after the date of the declaration of the results of the presidential election. (2) Within fourteen days after the filing of a petition under clause (1), the Supreme Court shall hear and determine the petition and its decision shall be final. (3) If the Supreme Court determines the election of the President-elect to be invalid, a fresh election shall be held within sixty days after the determination "

4.6.4 Adopting a Whistle-Blowers Policy

Corporations should adopt a whistleblower policy to allow the members of the corporation to report any employee or leader involved in fraud activities. Whistle blowing mechanisms are channels used to notify the organization about its employee's concerns about the conduct of business activities. In the UK all employers who report the wrongdoing in their company are protected by the law[297]. The corporations should enhance internal risk control measures through the establishment of an effective whistle blowing mechanism and embrace technological advancement to enhance detection and prevention of financial fraud and embezzlement, through reporting and proper, timely and accurate accounting. As Dick, Mose and Singales[298] report, fraud detection does not depend on obvious actors such as auditors and investors but instead, it relies on non-traditional players such as the employees, industry regulator and the media. Therefore, corporation should come up with reporting system where employees can report suspicious fraud activities anonymously to the relevant authority or the board of directors. As Lee and Fargher suggest companies adopting the whistle-blowing policy should provide the players with a high level of disclosure about the whistle blowing process and hotline channels that offer anonymity[299]. The policy should clearly state the role and the responsibilities of the directors and the employees so that any activity contrary to what is stated can be reported. To encourage whistle blowing, the player should be awarded a monetary award. Having access to rewards has a significant impact on the probability of the players becoming whistleblowers. The adoption of whistleblower policy is useful fighting fraud because it allows for anonymous reporting. To complement this policy, organization can also use machines learning classifiers to detect fraud. The machine uses the leaked information, social networks, financial data, rumours, and emotion features to compliment other methods of fraud detections[300]. Moreover, the government should enact a whistle-blower Act to protect those who report. This act has been effective in protecting whistle-blowers and reducing fraud in Japan[301]. Thus, all corporations

[297]Gov.UK, "Whistleblowing for Employees," GOV.UK, last modified December 13, 2011, https://www.gov.uk/whistleblowing.

[298] Alexander Dyck, Adair Morse, And Luigi ZINGALES, "Who Blows the Whistle on Corporate Fraud?," *The Journal of Finance* 65, no. 6 (2010) 2213

[299] Gladys Lee and Neil Fargher, "Companies' Use of Whistle-Blowing to Detect Fraud: An Examination of Corporate Whistle-Blowing Policies," *Journal of Business Ethics* 114, no. 2 (2013) 283

[300] Wei Dong, Shaoyi Liao, and Zhongju Zhang, "Leveraging Financial Social Media Data for Corporate Fraud Detection," *Journal of Management Information Systems* 35, no. 2 (2018) 461

[301] Coney Peter and Coney Christopher, "The 'whistleblower protection act' (Japan) 2004: A critical and comparative analysis of corporate malfeasance in Japan r 2016, Volume 42, Issue 1," *Monash University Law Review,* 42, no. 1

should adopt the whistleblower policy which should be well structured to encourage reporting and whistleblower protection

4.6.5 Stakeholders Participation

The government recognizes that the war against corruption requires the mobilization of a broad range of stakeholders, including civil society, the media, the private sector, faith-based organizations and professional bodies. Going forward, this broad-based participation and consultations with stakeholders will focus on workable initiatives oriented toward demonstrable results. Employees and other stakeholders should be given a forum and protections so as to raise issues anytime with no strict structures as rigid meetings and without fear. The stakeholders' cohesion and the personal traits of the leaders play a significant role in combating fraud and thus greater participation is encouraged.[302]

Additionally, the board should make a deliberate effort to combat fraud through being accommodative and changing its structure. Mangala and Kumali note that the top executives such as managers and directors are the ones responsible for implementing and enforcing anti-fraud policy within the organization.[303] Studies have found that the structure and composition of board correlate with fraud incidents[304]. To minimize the cases of corporate fraud, companies should have more independent directors to enhance the quality of the board[305]. Studies have also found that independence of the board, dedicated investors; effective audit committee provides active monitoring and thus reducing fraud[306]. Moreover, directors and managers should cultivate a social responsibility culture among all the stakeholders. Corporate leaders are moral actors who should make decisions based on their moral standard. These should be reflected on the employees and other independent stakeholders. According to Hajorto[307] managers who possess

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(2016) 41

[302] Fabio Zona, Mario Minoja, and Vittorio Coda, "Antecedents of Corporate Scandals: CEOs' Personal Traits, Stakeholders' Cohesion, Managerial Fraud, and Imbalanced Corporate Strategy," *Journal of Business Ethics* 113, no. 2 (2012) 264

[303] Deepa Mangala and Pooja Kumari, "Corporate Fraud Prevention and Detection: Revisiting the Literature," *Journal of Commerce and Accounting Research* 4, no. 1 (2015) 35

[304] Hatice Uzun, Samuel H. Szewczyk, and Raj Varma, "Board Composition and Corporate Fraud," *Financial Analysts Journal* 60, no. 3 (2004) 33

[305]Ibid Uzun, Szewczyk, and Varma.

[306] Abdul Ghafoor, Rozaimah Zainudin, and Nurul S. Mahdzan, "Factors Eliciting Corporate Fraud in Emerging Markets: Case of Firms Subject to Enforcement Actions in Malaysia," *Journal of Business Ethics* (2018)1

[307] Maretno A. Harjoto, "Corporate social responsibility and corporate fraud," *Social Responsibility Journal* 13, no. 4 (2017) 13

higher ethical values that are reflected by higher corporate responsibility activities are less likely to commit fraud. Strong corporate culture also helps to identify, preventing and eliminating corporate fraud[308]. The board ethical commitment is also significant in raising social corporate responsibility, corporate governance and corporate performance[309]. Furthermore, political and investor's participation can also reduce the incidences of fraud as noted by Wu, Johan, and Rui[310]. According to these authors, firms with good political and investor relation is not likely to engage in fraud activities to protect of reputation and continue benefiting from the connection. Therefore, stakeholder's participation will enhance good corporate government and culture and consequently reduce the involvement in frauds.

5.0 CHAPTER CONCLUSION

The analysis has examined the United Kingdom and South African legal institutional and policy framework on good corporate governance. The study was informed by the need to understand the lessons that Kenya can draw from these jurisdictions. The question to be answered was whether there are legal gaps that need to be filled in light of the study. The analysis was also aimed at finding out whether Kenya's institutional framework is better equipped to enforce the law and regulate the industry and lastly what lessons Kenya can draw on policy framework. One of the notable findings of the study is that the Kenyan and United Kingdom legal framework are almost similar and the Kenyan laws are mostly modelled around the English laws. For instance, the UK Companies Act 2006 and the Kenyan Companies Act 2015 contains the same provisions on the corporate governance and has codified the directors' duties and provided both the criminal and civil sanctions for those who do not comply with their duties. Therefore, it leaves room for one interpretation the high cases of corporate fraud can be attributed to poor enforcement of the law by the relevant bodies such as the Courts, Director of Public Prosecution and the Criminal Investigation Department hence the relevant bodies need to take the necessary actions by enforcing the laws as required.

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[308] Alleyne Beverley and Amaria Pesi, "The effectiveness of corporate culture, auditor education, and legislation in identifying, preventing, and eliminating corporate fraud," *International Journal of Business, Accounting and Finance (IJBAF)* 7, no. 1 (2013) 279

[309] Ahmad S. Salin et al., "The influence of a board's ethical commitment on corporate governance in enhancing a company's corporate performance," *Journal of Financial Crime* 26, no. 2 (2019) 1041

[310] Wenfeng Wu, Sofia A. Johan, and Oliver M. Rui, "Institutional Investors, Political Connections, and the Incidence of Regulatory Enforcement Against Corporate Fraud," *Journal of Business Ethics* 134, no. 4 (2017) 709

In addition, on the issue of the institutional framework, the enforcement approach is fragmented in different bodies. Therefore, the success of the bodies relies mostly on political goodwill and how better the relevant bodies are equipped to discharge their duties. Consequently, the high number of corporate frauds in Kenya such as Uchumi Limited, Nakumatt, Chase Bank can be attributed to poor enforcement by the Capital Markets Authority. Therefore, the relevant stakeholders need to understand the challenges facing the Capital Markets Authority such as lack of resources, more staffing, ensuring that the body's decisions are not overruled by the court on flimsy grounds. Also, the courts are to be blamed for lack of convictions and stalled cases. For instance, there have been no convictions on the high number of corporate scandals that occurred in the country such as the Uchumi, Nakumatt cases among other high-profile cases that led to the investor to lose their money.

Moreover, on the issue of policy framework the Kenyan, the South African and also the United Kingdom contains almost the same provisions. The policy frameworks in the mentioned countries are geared towards improving transparency, accountability and better management of the firms. The powers have been donated to the directors and there are various mechanisms that have been put in place to ensure that there is accountability by the directors e.g. through the annual directors' evaluation reports. Also, it has recommended that the majority of the board should have the majority of independent directors that are important in providing the check and balances. However, the approach to enforcement is different, the Kenyan and South African have adopted the same laws such as the Apply and Explain whereas the United Kingdom uses the "comply or explain". In this regard, the differences in enforcement mechanism are justified given the unique circumstances in the different bodies. Therefore, the Kenyan code of corporate governance in tandem with the international best practices and the relevant must make sure that it's implemented and as required by the law.

Other reforms that can assist in addressing corporate fraud in Kenya include arresting the directors and other company officials who are engaged in Fraud and expediting court proceedings involving fraud. In Kenya, although some companies have been under investigation for fraudulent activities, no official has been arrested. Thus, the relevant bodies should enforce the laws by arresting and punishing the players. This will deter others from engaging in such activities and reduce fraudulent cases overall. Additionally, the Fraud Act and Theft Act have

been enacted in United Kingdom and they worked and thus, they can be implemented in Kenya to provide comprehensive provisions that address all the dimensions in fraud. Additionally, the enforcement mechanism should be strengthened to encourage compliance with the existing laws. This can be done by applying both corrective and preventive measures. Moreover, Kenyan government, as well as corporations, should implement a whistle-blower policy that allows for anonymous reporting of misconduct in corporation stakeholder participation has also been identified as an effective way of establishing good corporate governance that is associated with a decrease in misconduct.

CHAPTER FIVE
CONCLUSION AND RECOMMENDATIONS

5.1 INTRODUCTION

The overarching aim of this study was to investigate, what is the existing legal, regulatory and corporate governance framework on corporate fraud in Kenya? Examine the various corporate governance mechanisms and their efficacy in addressing the corporate fraud? To explore the various ways in which the Kenyan laws can be improved to curb corporate fraud? This was done mainly through examining the existing Kenyan legal, institutional and policy framework on corporate governance and also borrowing the lessons from the United Kingdom and South Africa. The motivation behind commissions of corporate fraud is due to weak law, poor enforcement mechanism and lack of applying the existing policy framework on corporate governance by corporations. As such, there have been rising cases of corporate fraud in Kenya leading to failure of many corporations in Kenya such as Uchumi Limited, Nakumatt, Mumias Sugar Company Limited, and Chase Bank Limited among other corporations. The collapse of these corporations as a result of fraud has led to a lot of negative consequences to the country such as the loss of revenue to the government in form of corporate taxes, the loss of employment to many citizens rendering them jobless among other issues.

In addition, the various approaches that have been employed to address the issues have not been effective and as such, the issue of corporate fraud has persisted and remains a major threat to the failure of many firms. For this reason, enacting further legislation on corporate fraud such as Theft Act and also the Fraud Act and also enforcing the corporate governance principles would go a long way in addressing the issue of fraud in the country. The main focus of this study is to highlight the findings of this research. Section 5.2 of this research will emphasize on the outcomes and the issues identified in line with the stated research questions. Section 5.3 will highlight the significance of the results and finally, 5.4 of the research makes the recommendations that the policymakers need to implement in order to address the problems.

5.2 KEY FINDINGS

To achieve the main study of this research the question investigated the three main issues. The first question was whether there are legal, institutional and policy gaps that have led to the issue of fraud, examine the enforcement challenges that Kenya is facing towards tackling the issue and whether there are lessons that Kenya can learn from the United Kingdom and also South Africa on the issue of corporate fraud. Chapter two of the research established the point that the Kenyan legal, institutional and policy framework are ineffective in solving the issue of corporate fraud. The inefficacy stems from the fact that the issue of corporate fraud is complex and it manifests itself in various forms and there are poor enforcement mechanisms and also there are gaps within the law that need to be addressed.

First, the Kenyan legal framework has been ineffective in addressing the issue of corporate fraud. First, the Kenyan Companies Act, 2015 needs to be changed in order to increase director liabilities. Also, the study found that although Kenya has robust provisions on the duties of directors a major challenge has been with implementation. Many of the cases of corporate fraud that are occurring are as a result of the breach of the director duties such as the; duty of skill and care, the duty to promote the success of the business, the duty not to accept the gifts from third parties, the duty to exercise independent judgment among others. Also, there are no standalone laws that govern the issue of fraud which can help in consolidating and also providing various penalties.

On the institutional framework, the study notes that implementation of the law still remains a major challenge hence proves the point that Kenya suffers from poor enforcement of the law. The Kenya Capital Markets Authority is a major body that was established in order to govern the operations of companies and acts pursuant to the provisions of the Capital Markets Act. The Authority has taken firm decisions against some directors who are found to have contravened the provisions of the law such as fining them and also disqualifying them from holding positions in companies. Although there are some questions that have been asked on the fines imposed by the body as inadequate *vis*-à-*vis* the crime committed. Also, the body has taken more of a reactive approach in addressing the issue of corporate fraud rather than a preventive approach. It should be noted that the body established a unit within its body of Fraud Detection and Prevention;

though the decision to establish a unit was merited there have no tangible results that have been achieved so far and as such; there is need to re-evaluate the approach.

Also, the courts are major stakeholders in the fight against corruption and more, particularly corporate fraud. However, in the instant matter, the courts have been a major impediment against stopping the vice. Most of the directors who are charged with the offences of fraud get acquitted and also get favourable orders that act as an impediment against the fight. There are no reported cases where the directors have been convicted. Hence, the courts have a huge role in ensuring that the issue of corporate fraud is effectively tackled. In addition, the court through judicial review has quashed many decisions against the Capital Authority such as the fines and also the decisions to disqualify the directors from holding the position. Most of the cases that have been reviewed show a pattern where the court is more interested in upholding the individual's rights rather than collective rights of the citizens. There is little jurisprudence in the court that seems to promote discipline in the management of the corporations and without successful conviction of such cases; there would be no fear of deterrence.

On the Kenyan policy framework, the study notes that Kenya has good corporate governance code of conduct which when implemented effectively it would assist in tackling the issue. The code of conduct supports good management of companies and also states the directors have a huge role in steering the companies. Also, there are various policy guidelines that can be used in promoting transparency. However, the approach in applying the code of "apply and explain" is a challenge in realizing some of the good provisions and thus, it may be proper to revert to "comply or explain" which most countries applying and it has ensured there are more disclosures by the Board.

Chapter three examined the South African and also the United Kingdom, legal framework, institutional and policy framework. The study examined the United Kingdom Companies Act and also other statutory framework and observed that the director duties contained in the Kenyan Companies Act are similar to the United Kingdom Act and there are no differences. Also, the researchers observed that the United Kingdom has enacted Frauds Act and also the Theft Act which contains good provisions that can be used to combat fraud. Also, the study noted that the institutional framework in UK is fragmented between different bodies and is almost similar with Kenya and also challenge comes mostly with enforcement since the UK regulators are mostly

active in addressing and combating issues of fraud, especially after the 2008 financial crisis. Lastly, the UK corporate governance emphasizes on board independence, transparency in the management of the firm the same as the South African code of corporate governance.

Chapter Four of the research considered the lessons that Kenya can learn from South Africa and also the United Kingdom on corporate governance. First, one of the lessons that Kenya can learn from South Africa is repealing its law and including provisions that increase the director liabilities. The South African Companies Act, 2008, section 77(2)(*a*), (3)(*b*) and (3)(*c*) provide for director liabilities. Further, the jurisprudence in South Africa has been progressive in advancing the provisions of the law and the directors may also be imprisoned for violating the law. The decisions in the case of *Gihwala and Others v Grancy Property Ltd And Others*[311]and the case of *Rabinowitz v Van Graan And Others*[312]among other decisions have affirmed this position. Therefore, increasing director liabilities is one way that would curb the issue of corporate fraud and acts deterrence for errant directors who would want to embezzle the company resources.

Furthermore, the South African law on delinquency is one major provision that can help the Kenyan law to address the issue of corporate fraud. The South African Companies Act contemplates two main scenarios under which a director may be declared delinquent and placed under probation. The provision on delinquency as provided under section 162(5) and Section 162(7) has granted the courts the power to declare that a director is delinquent. This enactment is an innovative remedy that was undertaken in the year 2011 to assist the shareholders and also the stakeholders to hold the directors liable. This provision sets the standard for good behaviours that are expected of a director. Furthermore, it acts as a cushion to help the public against the dishonest and also incompetent directors. In addition, in South Africa, the law emphasizes on the shareholder rights of information which is an important tool that can help in the fight against corporate fraud. For instance, their law makes it an offence for company officials not to disclose information as demanded by the members. Also, the study noted that the South African Institutional framework is almost similar to the Kenyan and the differences are as a result of not fully discharging their duties as required by the law. Lastly, on the issue of policy approach, the

[311]*Gihwala and Others v Grancy Property Ltd And Others*[311]2017 (2) SA 337 (SCA)
[312]*Rabinowitz v Van Graan And Others*[312]2013 (5) SA 315 (GSJ)

South African code despite being similar to the Kenyan emphasizes on the Ubuntu philosophy that advocates for unity the human well-beings. Also, there is a lesson that Kenya can learn from United Kingdom on enforcement of the law and also developing the jurisprudence.

5.3 Importance of the Findings

Generally, the laws on cooperate governance can be used to address the problem of corporate fraud. In terms of adding to the existing literature on the topic; the findings of this research can assist in sealing the gaps that have been identified by various eminent scholars on the subject of corporate fraud globally. Since there is little local research on the subject this study is important in highlighting various ways in which the Kenyan laws can be improved.

Firstly, the study noted that there are some gaps in the laws that can be strengthened in order to address the issue of corporate fraud. The lessons from the United Kingdom and also South Africa can be instrumental in addressing the issue of corporate fraud that is affecting many corporations in the country. Also, the study noted that in terms of institutional approach the relevant agencies must apply the law as provided and also there is a need to fully equip the relevant agencies with the necessary resources. Also, it's important that there is a change in the policy approach more particularly the way the corporate governance law is applied. It would assist the policymakers to enact the necessary legislation and other policy that can help in remedying the situation. Also, by focusing on South Africa and also the United Kingdom made it possible to effectively examine whether the Kenyan legal regime is sufficient in addressing the problem of corporate fraud. Furthermore, other countries with the similar legal regime would benefit from the findings of the study by seeing the gaps in the law that have been pinpointed by this research and they can also borrow from the possible solutions that have been provided

In a nutshell, this research shows that Kenya can learn from South Africa and also the United Kingdom in order to improve its law. Additional this research lays the theoretic basis for the reform changes that can be undertaken in order to address the issue of corporate fraud and it also forms a background for further research on this subject. Also, the researchers noted that Kenya laws are mostly similar to the two countries that have been analyzed and it was noted that implementation of the law.

5.4 RECOMMENDATIONS

The discussion here will focus on the recommendations which are aimed at providing concrete solution and also other remedies. The recommendations have been categorized into five main classes. (1) The full implementation of the law as provided in the relevant statutes and also the corporate governance code of conduct. (2) There should be institutional reform to address the loopholes that makes the relevant agencies unable to discharge their mandate and seal the loopholes of corruption and fraud (3) Enacting other laws that can help in addressing the issue of fraud as seen in other countries (4) Establishing a Whistleblowers policy in major corporations in the country. (5) Arrest and conviction of director and company officials who are found to engage in fraud (6) the courts should expedite all the cases of similar nature and there should be a fixed period in determining such cases. (7) Adopt a collaborative and multi-sectorial approach and seek technical assistance (8) the board of directors should instill a good corporate culture.

Recommendation 1

The relevant agencies such as the Capital Markets Authority, the Office of Director of Public Prosecutions, the Courts and other major stakeholders need to implement the law as provided since non-implementation has been cited as a major obstacle in combating corporate fraud. Despite the comprehensive provisions of the director duties under the Companies Act 201 there has little that has been done to hold the directors who run down the companies accountable. The case of Uchumi Limited, Chase Bank, and the Nakumatt Limited exemplifies the problem of non-compliance. There is little jurisprudence in court that supports accountability on the part of directors.

Recommendation 2

It's important that the institutional framework that impacts corporate fraud to be reformed. Most of the institutions that have been charged with the duty of preventing fraud have not been able to discharge their duties efficiently. For instance, the Capital Markets Authority despite having the Fraud Prevention Unit in most of the cases has been unable to detect and also stop fraud from happening. Therefore, it's important that the relevant agencies be sufficiently equipped with the necessary tools and resources in order to prevent such from occurring. The necessary assistance could be through adequate staffing and other modern strategies.

Recommendation 3

It's important that the Kenya parliament enact new laws and also reform some existing laws in order to boost transparency and seal the existing loopholes in the law. The lessons from the United Kingdom and South African should be the basis for legislative reform. For instance, parliament should enact the Frauds Act and also the Theft Act which will assist in arrest and prosecution of different forms of corporate crimes. In addition, the Companies Act should be amended and a clause on delinquency introduced that compels the directors who are found culpable for gross misconduct to step aside.

Recommendation 4

A requirement that all corporations should prepare a whistleblowers policy and implement this would be a major progress towards early detection and also prevention of different forms of corporate crime. This will enable the employees to report any suspected misconduct and illegal activity to the relevant authorities. The said policy should contain the types of issues that can be reported, the manner in which the person who is reporting such misconduct can be protected from any form of victimization and the procedure of raising the concern and the manner in which the corporation concerned should respond to such a report.

Recommendation 5

Arrest, charging and successful conviction of directors and company officials who are found guilty of such acts is the surest remedy against such acts. Successful conviction of the cases involving corporate fraud would be deterrence against theft and embezzlement of company resources. In Kenya, there are few cases where directors have been sentenced to prison for different acts; therefore the court should apply the law strictly to ensure that such acts are stopped.

Recommendation 6

The court as a matter of urgency expedites on cases involving corporate fraud and there should be a timeframe for hearing and making a determination of such cases. The study recommends that such cases should be concluded within a period of 6 months in order to restore confidence in Judiciary. Also, a fixed timeline would reduce incidences of witness's interference and also

corruption and ensure there is fairness. The rationale and justification for this provision are despite the complexity of the presidential election in Kenya such matters are only determined within a period of 14 days and as such six months is sufficient period to hear and make a determination on such cases.

Recommendation 7

A more enhanced multi-sectorial approach between the different players such as the Capital Markets Authority and also the Office of the Different of Public Prosecution, the Office of the Criminal Investigation Unit, the Anti-corruption body and also the courts should be developed. These different bodies should develop a collaborative approach in discharging their constitutional and also statutory duties. Also, bodies such as CMA should seek technical assistance from their counterparts in the United Kingdom on the modern approaches towards addressing the issue of corporate fraud.

Recommendation 8

A corporate culture change spearheaded by the Board should be implemented at the company level. The boards are the driving will of the companies and implementing and introducing a culture of transparency, accountability, openness, integrity is important in making the employees of the company perform their duties without the temptation of engaging in acts that are detrimental to the well-being of the company and the society at large. The research recommends that Ubuntu Philosophy should be implemented in the Kenyan firms.

Recommendation 9

Further studies should be undertaken to determine impact of board composition and corporate fraud and the impact of the Kenyan Code of Corporate Governance as a deterrent to corporate fraud and Impact of the Kenyan corporate culture on rising cases of Corporate Fraud.

5.5 CONCLUSION

The current legal, institutional and policy framework on corporate governance needs to be reformed in order to address the issue of corporate fraud. The study of the United Kingdom and also South Africa have shown that Kenya can learn some lessons on the manner and ways in which corporate fraud can be prevented and also minimized. The study noted that the gaps within the Kenyan laws need to be filled in order to address some of the challenges that the country is facing towards addressing these problems. For instance, the study notes that enacting further legislation on corporate fraud can help cover different scenarios of the problem and also sentences enhanced in order to deter people from engaging in such acts that have led to the failure of many firms. Laws such as the Frauds Act and also the Thefts Act will go a long in addressing some of the challenges as seen in United Kingdom. Also, the Kenyan Companies Act 2015 should be amended to include provision on delinquency of directors that can be activated by shareholders and also other stakeholders to compel the director to step aside if there are sufficient grounds that shows gross misconduct. The shareholder rights to information should be enhanced to ensure that the members get timely and accurate information about the companies and also penalties should be provided for non-adherence. The liabilities of the directors should also be included in the Companies Act 2015 to promote compliance with the director duties and also other provisions of the Act.

In addition, a different institutional approach should be embraced in order to be able to enforce the law as required. The relevant institution such as Capital Markets Authority should adopt a more proactive preventive approach rather than a reactive approach in addressing the problem of corporate fraud. Also, more resources should be made available to the Authority to ensure that it's better equipped with the necessary funds and also more staff in order to work efficiently. The commission should also collaborate with other Authorities in other countries such as the United Kingdom for technical in the operations and enhance its work. Also, the multi-sectorial approach needs to be improved in order to make detection easy and also preserve evidence and ensure speedy prosecution of officers involved. In this regard, the Office of the Director of Public Prosecution, the Capital Markets Authority and also the courts need to work in Harmony. Also, the courts need to expedite on some of the pending cases in court on the issue and ensure that those who are culpable face the law as required. In addition, the court should desist from issuing

orders that impede on the work of the Capital Markets Authority making some of the suspects to walk out free.

Lastly, there is a need to have a policy shift in the enforcement of the Code of Conduct. The paper recommends a “comply and explain” approach in the application of the code of conduct since it has been shown to be successful in the United Kingdom and other countries. The said approach encourages more disclosures and also harmony between different players in the industry. More importantly, there should be a corporate culture change in the management of the firms. The board of the directors should emphasize the culture of integrity, transparency and also working in unity. For example, in South Africa, Ubuntu philosophy is a major culture that promotes working together for the betterment of society. Further studies should be undertaken to determine impact of board composition and corporate fraud and the impact of the Kenyan Code of Corporate Governance as a deterrent to corporate fraud and Impact of the Kenyan corporate culture on rising cases of Corporate Fraud.

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